United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

74-1244

B P/S

United States Court of Appeals
FOR THE SECOND CIRCUIT

ANTOINETTE M. BRAGALINI, ARNOLD DAMSKY, WILLIAM WEINSTOCK, CARL ROGERS and ROSE ROGERS, H. L. FEDERMAN & CO., INC., SUZANNE MASTERS, STEPHEN MASTERS and NORMAN KEMPER, individually and as Stockholders of MASTERS, INC., suing in behalf of themselves and for the benefit of said corporation and for the class of all other stockholders of said corporation similarly situated,

Plaintiffs-Appellants,

against

LOUIS BIBLOWITZ, MAX BIBLOWITZ, JOSHUA BIBLOWITZ, RALPH J. WEINER, JOEL BIBLOWITZ, ARNOLD GINSBURG, HERBERT ABRAMSON, HARRY GRUNTHER, HARRY L. LEWIS, PINCUS PETERSEIL and MASTERS, INC.,

Defendants-Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF INDIVIDUAL DEFENDANTS-APPELLEES

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BRIEF OF INDIVIDUAL DEFENDANTS-APPELLEES

Preliminary Statement

This brief is submitted on behalf of the individual defendants-appellees in this appeal from the unreported decision of Hon. Constance Baker Motley after trial without jury.

The Issues

1. Whether the findings of fact made by Judge Motley were clearly erroneous; and
2. Whether Judge Motley applied the appropriate legal principles to those findings of fact.

Statement of the Case

This case was instituted as a class and derivative action on behalf of Masters, Inc. alleging violations of § 17(a) of the Securities Act of 1933, of § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 of the Rules of the Securities and Exchange Commission and alleging breach of the common law duty of fiduciaries (7A).* No violation of § 14 of the Securities Act is alleged; Masters, Inc. was not subject to its provisions (Tr. 579).** As noted in *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F.2d 1281 (2d Cir. 1973), the proxy statement was issued (p. 1300):

> "* * * as a result of what the SEC has properly called 'a commendable and growing recognition on the part of the industry and the investment community of the importance of informing security holders and the public generally with respect to important

* References to the Appendix pages are numbers with the letter "A".

** References to pages in trial transcript are "(Tr.)".

business and financial developments.' Securities Act Release No. 3844 (Oct. 8, 1957). Imposition of too liberal a standard with respect to culpability would deter this, particularly in light of the almost unlimited liability that may result. * * *"

The complaint sought, *inter alia,* to set aside the merger of January 1967 of Lady Rose Stores, Inc. ("Lady Rose") into Masters, Inc. ("Masters"). The Conclusion of appellants' brief, however, concedes (Br. p. 69):*

> "It is, of course, too late to unscramble the merger effected in 1967; so the District Court should be instructed to formulate an appropriate remedy of restitution, * * *."

The District Court's Findings of the Value of Masters Were Not Clearly Erroneous

A. Legal Principles

Initially, reference to certain basic legal principles should be made.

Rule 52(a) of the Federal Rules of Civil Procedure provides, in relevant part, as follows:

> "Findings of fact shall not be set aside unless clearly erroneous and due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses."

In applying the Rule 52 standard, this Court, in *Lanza v. Drexel & Co.,* 479 F.2d 1277 (2d Cir. 1973), recently wrote (pp. 1280-1, 1289):

> "Our appellate task, therefore, is to review the record in order to ascertain whether there is proof sufficient to support Judge Frankel's fact-findings and conclusions. Conversely, *our task is not to re-evaluate*

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* References to pages of appellants' brief are "(Br. p.)".

the proof but only to determine whether the fact-findings are 'clearly erroneous.'

> "* * *
>
> "We have no difficulty in affirming Judge Frankel's finding of fact. Our review of the evidence demonstrates that the finding that Coleman did not know of, or knowingly participate in, any deception practiced upon plaintiffs is amply supported by the evidence and at the very least is not clearly erroneous. *See* Fed.R.C.P. 52(a)." (Emphasis supplied.)

And, in *Wolf* v. *Frank,* 477 F.2d 467 (5th Cir. 1973), the Court wrote (p. 473):

> "The defendants' briefs and arguments are predicated upon facts and inferences and conclusions that the trial court neither found nor was compelled to find. In the welter of charges and counter charges the ensuing obfuscation can be visioned away by the application of a relatively few simple legal propositions, the most elementary principle being that appellate courts are governed by the 'clearly erroneous' test of Rule 52(a) of the Federal Rules of Civil Procedure when they review District Court fact findings. In applying this test, we have said:
>
> > 'The question is not simply whether the reviewing court would have found otherwise but whether the trial court could permissibly find as it did. The reviewing court should upset a finding only when it "is convinced on the whole record that the finding does not reflect the truth and right of the case." Wright, Federal Courts § 96, at 432.'
>
> Movible Offshore. Inc. M/V Wilken A. Falgout, 5 Cir. 1973, 471 F.2d 268, 271. Defendants' brief oftentimes totally fails to evidence an awareness, much less an understanding, of this controlling principle of appellate jurisprudence."

B. The Financial and Operational Conditions of Masters

Next, the operational and financial conditions of the two parties to the merger must be examined and understood because the core of appellants' position is that the terms of the merger between Masters and Lady Rose were unfair to the Masters minority stockholders and, as a result, appellants seek restitution. They do not seek the setting aside of the merger, in effect for seven years, nor a revote on the question of such merger. Because of this seeking of restitution and because the District Court's findings that the terms of the merger were fair are not clearly erroneous, the judgment must be affirmed.

Appellants would have this Court conclude that at the time of the merger Masters was a viable company worth $3,000,000 (Br. p. 66). To support their position, appellants have selected certain items to the exclusion of basic reliable qualitative factors which they seek to dismiss as appellees "poor mouthing" coupled with appellants' utilization of innuendo and suggestion of lack of ability, if not worse, of those professional people who testified on behalf of appellees. The facts, however, are that Masters was not viable and worth no more than $500,000.

Masters, from 1937 to 1956, operated a single store on 48th Street in Manhattan and from 1956 to 1962, added nine stores. On January 31, 1963, it filed for reorganization under Chapter XI of the Bankruptcy Laws (28A). On July 29, 1963, a 40% Plan of Arrangement for Masters was adopted (30A). The Creditors Committee, through this Plan, placed severe restrictions on Masters (31A). The Plan provided, *inter alia*:

> (a) that Masters shall employ Lehrer & Abrams* as certified public accountants for the preparation of quarterly and annual reports;

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* This is not Masters' independent certified public accounting firm which was Kalish Rubinrcit & Company.

(b) for a payment schedule with acceleration in case of default;

(c) for the deposit of letters of resignation of all officers and directors pending receipt of full payments to the Creditors Committee ("full payment");

(d) that no dividends would be declared or paid until full payment is made; and

(e) that without prior consent of the Creditors Committee (i) no new lease could be entered into; (ii) no cash bonuses or pensions could be made to any officer or director; (iii) Masters could not open any new stores or close any old ones; (iv) could not pay any more than $70,000 to its president and to its treasurer. (Exh. 2, Plan, pp. 1-5).

Masters could not make a major policy decision without the prior approval of the Committee (Tr. 469).

Shortly after the Plan was adopted, Masters had five stores: 48th Street, New York, New York; Elmsford, New York; Lake Success, New York; Flushing, New York; Central Plaza, Miami, Florida. In 1964, with the approval of the Creditors Committee, it opened two more stores in Florida in order to spread its overhead. The sources of the funds to open the new stores were not from profits but from the company's then cash funds ($400,000), the sale of debentures ($412,000), and an increase in its obligations to its trade creditors ($1,000,000) (31A, 32A; Tr. 427).

The 48th Street store had never shown a profit and the situation at the store was a deteriorating one. By 1966, it required refurbishing, had a serious pilferage problem and a high overhead. As early as August, 1966, Masters was negotiating to renew the lease because Jack Haizen, then the president of Masters and Kenneth Kopelson, its chief financial officer, had advised the board of directors that Masters could not continue to operate with its overhead spread over only three stores. Moreover, they advised that since 48th Street was Masters' original store,

its continued operation was essential to the corporation's image. Cogent evidence of Masters' precarious financial status was the 48th Street store's landlord's refusal to accept Masters' credit and insistence that Masters deposit $50,000 as security to renew the lease. The store was eventually sold (before the trial) because of its continuing losses (32A; Tr. 875, 526, 1428, 1429, 1476, 221, 224, 91, 539, 1430, Exh. 2, p. 3, Exh. 6, Exh. 5, p. 4).

The Flushing store likewise had never made any money and by 1966 also required refurbishing (32A). Its lease was onerous, its fixtures were antiquated, it lacked the merchandising approach of its competition in the neighborhood and a considerable amount of money was needed to update the store (Tr. 526, 875, 1435, 539, 540).

The Lake Success store was for accounting purposes at best a break-even operation. In 1966, it was in poor condition and was spread over two floors in two buildings (33A; Tr. 542, 875, 1435, 1436, 1779).

The Elmsford store was the only one that generated any profits. However, it needed refurbishing and had to relinquish part of its space to a bank. After the merger of Lady Rose into Masters, it was refurbished at a cost of more than $600,000 and a liquor store was added (33A; Tr. 541, 875, 1436).

As of 1966, Masters did not have the proper assortment or quantity of merchandise to continue as a mass merchandiser and the merchandise which it did have was soiled, damaged and stale. The stores were inadequate and the operation outmoded (33A; Tr. 1780, 2106-2110, 2113). The inventory in 1966 in the four metropolitan stores was not in a condition either to yield reasonable sales volume or profit margins. Statistically, this poor inventory at July 30, 1966 amounted to $2,487,737, or 54%, of its then total current assets of $4,574,511 and equalled 143% (1.43 x) its working capital of $1,738,653 (98A, 99A, 189A).

In addition to the totally inadequate merchandise, Masters also had chaotic management (Tr. 1780, 2106-2110,

2113). Indeed, when the subject of merger was discussed with L. M. Rosenthal, of the investment firm of L. M. Rosenthal & Company, it was Rosenthal's opinion that in the attempt to turn Masters around, the services of its then president, Jack Haizen, had to be terminated (Tr. 1043). Haizen resigned in September of 1966 and was succeeded by Kenneth Kopelson, the chief financial officer, who had no merchandising experience and was simply a stop-gap chief executive officer (Tr. 532). The Biblowitzes, while possessing soft goods experience through their operation of Lady Rose, had no hard goods experience (Tr. 1452).

Beginning in early 1966, Lady Rose had attempted to find new management for Masters. It employed a management consultant and tried unsuccessfully to hire several new management people with hard goods experience. It was only after the merger, when the assets of Lady Rose were added to those of Masters, was it able to employ Charles Laura, formerly of Times Square Stores, to head its hard goods operation (Tr. 1439, 1440, 2107, 2111).

For the year ended May 2, 1964, on sales of $19,074,937, Masters reported a net loss before special items of $52,588 (96A).

For the fiscal year ended May 1, 1965, Masters reported an operating income of $31,995, before taxes, and, after realizing income from prepayment of long-term obligations, only $79,212 on sales of $29,659,768 (Exh. 129) (36A).

On Masters' volume, its profit of sales should have been 2% to 2½% of sales, or, on sales of $29,659,768, between $593,195.63 and $741,494.30 (Tr. 857). A reported operating income of $31,995, before taxes, on sales of $29,659,768 cannot be equated with a profitable or viable operation because there is neither a cash nor an earnings return (Tr. 1715, 1779).

For the fiscal year ended April 30, 1966, Masters reported a net loss of $259,737 (97A) and for the fiscal year ended January 28, 1967, a net loss of $1,158,240 which in-

cluded a $585,616 loss on the sale of its Florida stores (Exh. F, p. 3).

In the opinion of Masters' counsel, its chief financial officer and its directors who testified at trial, Masters, in 1966, was headed for another bankruptcy (34A; Tr. 530, 871, 872, 47, 107, 110, 149, 2044).

According to Kopelson, Masters' chief financial officer, the principal cause of Masters' failure to realize profits was in its inability to sustain a reasonable volume with a reasonable gross profit. When it succeeded in raising its gross profit, it suffered concurrent losses in volume. It could not take advantage of an advertising umbrella, i.e., the coverage of a geographic area with a minimum run of a newspaper to spread that cost over a number of stores. This problem was particularly acute in the metropolitan stores and its advertising costs were exceedingly high in relation to the volume generated because each store had to absorb its own high advertising costs. Masters was at a severe advertising disadvantage in Manhattan, in Queens and in Westchester, with respect to each of its metropolitan stores since it was necessary to run advertisements in newspaper editions having circulations much broader than the areas from which the stores drew their customers. This placed Masters at a competitive disadvantage with other retailers of major appliances which could take advantage of the advertising umbrella (34A; Tr. 858-863, 867). And, according to Kopelson, it was unrealistic to think that Masters could open new metropolitan stores to spread the overhead (Tr. 867).

Kopelson also testified that in early 1966 he considered the idea of a merger for Masters in an attempt to solve its financial difficulties (Tr. 866). In addition, other alternatives were considered by him, for example, the expansion by the company of the number of its stores in the metropolitan area but none of the alternatives was realistic (Tr. 867, 868). His testimony was (Tr. 868, 869):

> "Q. You went on to say in that answer, did you not, 'We had tried them all.' That is, all the alternatives.

'The basic arithmetic of mercantile operations is simple. Merchandising, of course, is subjective and complex, but the arithmetic is essentially very simple. We had worked over a period of time to increase our gross profit, which historically had been a very weak point in the Masters operation. We had attempted to reduce our operating expenses, but sometimes this becomes an ever-descending spiral. If you reduce your advertising expenses, your volume may drop proportionately more. If you reduce your payroll gross dollar expense, you may be unable to adequately staff a store and you may find that by reducing your gross dollar payroll expense you've actually increased your percentage of payroll expense and total volume."

That was your full answer.

"A. Yes.

"Q. And that was a pretty good description of what had been going on at Masters up to that time?

"A. I think so.

"Q. You were in a vise, isn't that right?

"A. Yes.

"Q. You were in a vise and you did not know how to get out of it.

"A. We weren't able to get out of it."

The District Court found, in accordance with the opinion of appellees' expert (65A):

> "Further compounding the difficultires to obtain [sic] earning power for Metropolitan Masters was the sale in July 1966 of Masters' Florida operations. The Florida operations had absorbed a portion of Masters' central overhead which included expense items such as buying, bookkeeping and home office administration." (199A)

Their expert also added that to obtain earning power, it was important for metropolitan Masters to expand so

that central overhead could be spread over more operations. However, Masters did not have enough credit standing to negotiate reasonable leases, to finance inventory or to attract able operative management (199A).

According to its present head of hard goods, in 1966 (Tr. 2107):

> "* * * The only way that Masters had any hope of salvation was by the infusion of a lot of money and opening new stores and closing down most of the plants. * * *."*

From April 30, 1963 (after adoption of the Plan of Arrangement) to July 30, 1966, Masters' working capital had declined from $3,247,790 to $1,738,653; its net worth dropped from $2,718,092 to $1,781,174; and its retained earnings fell from $1,367,920 on May 2, 1964 to $580,604 (189A). Moreover, these statistics do not reflect the poor state of the inventories and the lack of funds available to metropolitan Masters to make expenditures necessary to expand the number of stores and refurbish the existing stores in order to make Masters a viable operation (35A). Indeed, in 1966, Masters' working capital was such that it could only liquidate; Masters could not stay alive with it for any length of time as a going business (Tr. 1724, 1725).

In July, 1966, Masters, as a first step in an attempt to improve its condition, sold its three Florida stores to Zayre Corp. which significantly would not assume any of Masters' liabilities other than its leases. The sale was made by Masters to stem losses and to realize some cash to attempt to stay in business (37A; Tr. 429, 554, 555, 865, 866, 1598, 1599; Exh. BF; Exh. 2, n. 8, p. FS-3).

Because of the lack of bargaining power of Masters resulting from its continual losses and because of the in-

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* In the words of appellees' expert (198A):
"At the time of the merger, Masters was in need of a rescue operation. * * *"

ferior quality of its inventory, the sale to Zayre Corp. resulted in a loss to Masters of $561,367 (37A; Exh. 2, p. FS-8) and constituted a discount of 77% of Masters net assets (Tr. 1836, 1950-1953).

As a result of the sale of the Florida stores to Zayre Corp., Masters had a stated net cash inflow of approximately $1,508,000 after a full retirement of its Subordinated A and B debentures in the amount of $250,000 and $162,000 (38A; Stipulated fact, pre-trial order, p. 3). The debenture holders required such retirement as a condition to consenting to the sale (Tr. 1952).

The $1,508,000 was used to pay creditors (Tr. 1951), to acquire the shares from Haizen, in return for the termination of his contract (Exh. 5) (38A), to obtain a certificate of deposit of $100,000 in connection with the payment to creditors under the Plan of Arrangement and $50,000 was used as security to accomplish the renewal of the 48th Street store lease (55A; 119A; 120A).

Kopelson, who appellants agree was the individual most familiar with the financial situation at Masters (Br., p. 32) testified (p. 843):

> "Q. Now, am I not right that during the entire period '63 to '66 * * * "

and at pages 844 and 845:

> "Q. And as a matter of fact, the metropolitan operations were not very successful during those three years?
>
> "A. No, they were not.
>
> "* * *
>
> "Q. Indeed, they were in your judgment, unsuccessful, were they not?
>
> "A. Yes."

Masters' financial condition in 1966, both before and after the sale of the three Florida stores to Zayre Corp., was found by the trial court to be precarious (32A)—and properly so.

Appellants contend that for the nine months ended January 29, 1966, the four metropolitan stores recorded a profit of $87,000 and $73,000 for the three months ended July 30, 1966 (Br., p. 5). The latter are unaudited figures (97A). As noted heretofore, such numbers are meaningless in a vacuum. In order to have any meaning they must be compared with the sales for the particular period. For example, the total sales for the nine month period was $17,938,670 (97A). 2% to 2½% thereof is $358,773 to $448,466. Thus, the $87,000 figure is far short of what a viable company would generate on such sales. Moreover, according to appellants, unaudited results are not entitled to much weight (Br., p. 44). While their remarks there are addressed to Lady Rose figures, it would seem that they cannot successfully argue that Lady Rose unaudited figures are not entitled to much weight but Masters unaudited figures are. More important however, is appellants' failure to apprise the Court of the results of operations of the metropolitan stores for a full year which would take into consideration the seasonal aspects of Masters' business. Those results show that for the fiscal year ended April 30, 1966 the metropolitan stores reported, not a profit but a loss of $3,225 (a total loss of $259,737 (97A) less the loss from the Florida stores of $256,512) (147A).

Moreover, the periods of "profit" to which appellants refer and, indeed, the loss of $3,225 for the fiscal year ended April 30, 1966, occurred prior to the sale of the three Florida stores, and, therefore, Masters reported that profit and such loss only when its central overhead was spread over seven stores (four in New York and three in Florida) with the Florida stores absorbing part of that overhead. And, the nine month and three month reported profits of the metropolitan stores stemmed from the Elmsford store which, according to Masters' chief financial officer, had to carry the other three metropolitan stores and did not make sufficient money to do it. In addition there was no way that Elmsford could be changed or expanded to carry the entire metropolitan operation and he so informed Masters' board of directors (Tr. 875-877).

Significantly, according to the report of Lehrer & Abrams & Co., the accountants for the Creditors Committee of Masters, for the 39 weeks ended October 29, 1966, Masters reported a net loss of $996,443 compared with a loss of $558,596 for the same period the year before (180A). For the 13 weeks ended October 29, 1966 the four metropolitan stores reported a loss of $201,618 compared with a reported loss of $189,641 for the four metropolitan stores and three Florida stores for the same period during the prior year (180A). In short, for this quarter the four metropolitan stores reported losses of more than those reported for the combined metropolitan and Florida stores during the same quarter the year before (Exh. O, p. 3) (36A, 37A). And, during this quarter alone, i.e., the 13 weeks ended October 31, 1966, according to this report, Masters' current assets had dropped $1,076,486 while its current liabilities dipped $682,788 and its working capital dropped $393,698; its shareholders equity dropped $290,234 (185A).

Crucially, Masters certified report on operations for the year ending January 28, 1967 shows that the operating loss for the metropolitan stores on total sales of $18,018,217.29 was $360,330.08. 48th Street, Flushing, Elmsford and Lake Success lost respectively $175,147, $141,909, $7,204 and $36,070 (Exh. F, p. 9). Thus, instead of realizing the needed 2% to 2½% of profits, or between $360,364.34 and $450,455.25, the metropolitan stores showed a loss of $360,330.08—a difference of between $720,694.42 and $810,785.23.

As Kopelson testified there was but one quarter during the fiscal year ending January 28, 1967 when Masters' metropolitan stores showed a profit and that was the quarter ending July 30, 1966 (Tr. 852):

> "Q. They lost $90,000 in the three month period ended April 30, 1966, right?
>
> "A. Yes, sir.
>
> "Q. And then that loss was reduced as of July 30, 1966 to $16,000?
>
> "A. Yes.

"Q. So in effect you picked up about $74,000?

"A. Yes.

"Q. You reduced your loss?

"A. Yes.

"Q. And then in the next period to October 30, 1966, the loss grew to $198,000? Correct?

"A. That is correct.

"Q. And then for the full period, the loss grew to $360,000? Correct?

"A. Yes."

In the attempt to extricate themselves from the impact of these latter figures, appellants' counsel state in a footnote at page 28 of their brief:

> "While Masters showed a loss of $360,000 for its metropolitan stores for the fiscal year ended January 28, 1967, that loss must be viewed in the context that the report was issued on May 8, 1967 (DX F), after the Biblowitzes knew that plaintiff stockholders of Masters through their counsel had taken the position that Masters was seriously undervalued in the merger; in addition, there was an incentive to write down the Masters inventories in fiscal 1967 with a view to maximizing losses and thereby assuring that Masters in the future would operate profitably and be better positioned to utilize the tax loss carry-overs."*

in spite of the fact that appellants' own expert, Marx, did not see Masters writing down anything that was questionable. At pages 1353 and 1354 of his transcript, he testified:

"Q. Mr. Marx, do you know what 'big bath' accounting is?

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* Significantly, appellants failed to apprise the Court that both the accounting firms for Masters and for the creditors committee (Kalish Rubinroit & Co. and Laventhal Krekstein, Griffith & Co., formerly Lehrer & Abrams) each certified to the fact that operations for the fiscal year ended January 28, 1967 were fairly stated (Exhs. F and M respectively).

"A. Well, I assume it means big writeoffs; no?

"Q. That's all it means to you? Have you ever heard of any special accounting techniques which are used when a losing company is taken over by another company?

"A. Well, it has been my experience that when this happens, during the initial period, you can expect a very careful analysis of the balance sheet and write-offs of anything or writedowns of anything that is questionable.

"* * *

"Q. You have seen that happen many times? Did you see it happen here?

"A. Well—

"Q. In the Masters situation?

"A. Did I see it happen?

"Q. Yes.

"A. Well, the answer would be no."

In any event, and of utmost importance, appellants introduced absolutely no evidence whatsoever to support their surmise and innuendo.

Appellants contend, in spite of all of the foregoing, that since on October 31, 1966, Kopelson projected Masters being a break-even operation at least or showing a small profit for the six months ending January 31, 1967 that (Br. p. 32):

> "* * * represented the best objective appraisal of the then current operations of Masters."

In connection with his projections, Kopelson forthrightly testified (Tr. 863):

"Q. And actually your projections were always a little more favorable than the events turned out.

"A. Yes, they were."

And, at page 864:

"Q. Where did you go wrong in your projections?

"A. In certain operating costs we found that we had

to spend more for advertising and generally the volume did not come in as predicted."*

At page 872, after the sale of the Miami stores, Kopelson testified about the metropolitan stores:

"Q. And when you said it was at best a break-even and the outlook was bleak, you knew that if something weren't done this company was headed for another insolvency proceeding?

"A. Yes.

"* * *

"Q. And, indeed, sir, you were not yet finished with the last insolvency proceeding at this moment?

"A. Yes."

Whether the break-even projection by Kopelson was or was not the best appraisal is of no consequence since the fact is that it was off by some $360,000! The District Court's characterization of Masters' prospects as "unpromising" is kind, considering the aforementioned evidence presented to it and its finding (38A):

"While the sale of the Florida stores helped reduce the drain off of working capital, it appears that Masters I continued to be in a difficult position."

was not clearly erroneous.

Appellants offer certain facts at pages 14 and 15 of their brief in an attempt to demonstrate, in face of all of the evidence to the contrary, that Masters was not in a poor financial condition; for example, that as of July 30, 1966, the working capital for each of Masters and Lady Rose was approximately the same numerically, i.e., $1,800,000. While this is true, it is, in vacuum, meaningless and misleading. The working capital of Lady Rose had steadily increased from $835,701 in 1964 to $1,821,070 as of August 31, 1966 (191A). Indeed, it rose to $1,987,369 as at Janu-

* It should be noted that appellees' expert found that there was no statistical basis for such projection (Tr. 1846).

ary 28, 1967 (191A). Masters' working capital had steadily dwindled in the same approximate period from $3,078,156 (190A). As at January 28, 1967, when Lady Rose's working capital was $1,987,369, Masters had dropped to $1,168,887 (190A). In addition, appellants do not advise the Court that Masters' total sales greatly exceeded these of Lady Rose so that Masters should have had a working capital greatly exceeding Lady Rose's. As noted, Rubinroit, of Kalish Rubinroit, testified that Masters working capital was such that it could not stay alive for any length of time; it could only eventually liquidate (Tr. 1724, 1725). Appellees' expert's testimony of two companies with the same numerical working capital shows that an equality of numerical working capital can be meaningless (Tr. 1849):

> "Two, I think it should be pointed out that financial statements have a dynamism of their own, even if they are of the moment of time. If I take two companies with equal working capital, exact same figures in the balance sheet, one is operating profitably and one is operating at losses, one has a record of profits, one has a checkered record, one has a cohesive management, one does not, despite the very same working capital figures one will find itself with a very weak financial position relative to the other.
>
> "So the balance sheet figures have to be related to other figures. I think, as I wrote, every financial figure is related to, derived from, and a function of some other figures."

And, it must be remembered that Masters' poor inventory at July 30, 1966 totalled $2,487,737 or 1.43 x its working capital of $1,738,635 (98A, 99A, 189A).

Appellants discuss the payment of indebtedness to the Chapter XI creditors as evidence that Masters was not in a poor financial condition. However, as Mintz, a partner of Kalish, Rubinroit & Co., testified (Tr. 1670):

> "Q. * * * Where did the money come from to pay off the creditors of the company when the company adopted its Chapter XI plan?

"A. Well, there's only two sources for paying off debt—three sources. One source is earnings. The company didn't have any earnings. A second source would be refinancing, borrowing new money to replace old debt, which did not occur. And the third source would be out of the general working capital of the company. That is where the money came from."

That, as does all of the evidence, it is submitted, does show the precarious financial condition of Masters, perhaps best articulated in its attorneys' letter to the Internal Revenue Service of January 20, 1967, reading in part as follows (Exh. N):

"* * *

"As required by Section 10 of the Plan of Arrangement, request was made of the Creditors' Committee to have a meeting to obtain its consent to the merger. The first available date which the Committee could and would grant was January 12, 1967. At such meeting the creditors desired to have a report of the independent certified public accountants showing the financial condition of the Company as of the last quarter-annual period ending October 29, 1966. This report could not be made available by the accountants until January 12, 1967. As a matter of fact, the writer attended the meeting on that day and the Committee was obliged to wait forty-five minutes until the report was completed, assembled and first brought in by the Committee's accountants.

"This report showed some very startling factors as to Masters' financial condition. It showed that for the 39 weeks ended October 29, 1966, Masters had lost $996,433 and that this added to a deficit at the beginning of the period of $1,709,150, brought the operating deficit of Masters since the adoption of the Plan of Arrangement to $2,705,583.

"The creditors immediately perceived that unless Masters had poured into it immediately fresh capital assets, its deteriorating financial situation would continue and spell its bankrupt end. The Plan of Arrange-

ment provides that if a periodic monthly installment is not made, the Creditors' Committee can call all unmatured payments due and force the resignation of the officers and directors and appoint a general manager of the corporation to take such steps as may be necessary to protect the interests of the creditors. The Plan also provides for other stringent measures which the Committee might compel because the loss aggregated more than $400,000.

"As a result of the meeting, the Creditors' Committee did give its consent but that consent is expressly conditioned upon the requirement that the installments immediately coming due, to wit: those of January 27, 1967, February 27, 1967, March 27, 1967, April 27, 1967, must be paid in accordance with the provisions of the Plan of Arrangement. (A copy of the Consent as forwarded by the attorneys for the Creditors' Committee is enclosed).

"The continued ability of Masters to meet these payments and maintain a working capital position so as to procure credit manifestly becomes highly questionable and uncertain. To continue in business during the characteristic very slow, hazardous period of January, February and March, made the merger with Lady Rose not only imperative, but urgently immediate. Masters, Inc. had no control whatsoever over the scheduling of the meeting of the Creditors' Committee.

"A meeting in December was requested, but this request was not granted. Likewise, Masters had no control over the activities and functioning of the independent certified public accountants without whose report the Creditors' Committee would not act.

"Further adding to the need for immediate action is the recognition by Masters, not only of the essentiality for fresh capital assets (and the merger will inject Lady Rose cash into Masters of upwards of $1,500,000), but also the imperative requirement of increasing its volume of distribution in the Metropolitan area of New York. Characteristic of the discount department store business is the spreading of its advertising and

overhead umbrella over as large a volume of sales as possible. In order for Masters to survive, it *must* acquire additional locations in the Metropolitan area. For months it has been negotiating for a location on Route 17, Paramus, New Jersey. These negotiations have been carried on with Messrs. Stanley Abramson and John Tully of Super Market General, a company on the American Stock Exchange which operates large shopping centers in the Metropolitan area. However, this company will not consider a lease with Masters, Inc. in its present credit posture and has taken the firm position that unless the merger goes through immediately, it will give no consideration to further negotiations.

"Masters, Inc. has been carrying on negotiations with the Flatbush Discount Center Company of which Mr. Jack Sapoff is President, for a location on Cropsey Avenue, Brooklyn, New York. Here again, Masters, Inc. could obtain no arrangement because of its present debilitating financial posture. Mr. Sapoff stated in no uncertain terms that absent an immediate merger, the contemplated venture would be abandoned.

"* * *

"* * *

"In sum, Masters had no control over the timing or rendition of the independent outside certified public accountants' reports for the quarter ending October 29, 1966 and no control over the scheduling of the meeting of the Creditors' Committee, without whose consent there could be no merger. Masters' worsening financial condition emphasized the risk of possible default under the Plan of Arrangement and the drastic consequence flowing therefrom. The urgent necessity for immediate strengthening of Masters' credit standing so as to enable it to deal effectively in procuring additional outlets adds to its plea for expeditious consideration by the Internal Revenue Service.

"Your considerate cooperation is respectively requested because in the absence of a favorable ruling

> by January 26, 1967, it is highly unlikely that the creditors are prepared to forego the payment due the following day, the merger will fall through and Masters will face bankruptcy."

In light of the foregoing, the District Court's findings that (26A):

> "* * * They [appellees] could certainly have reasonably concluded that a merger was essential to the company's [Masters'] survival in view of its poor economic condition and need for additional capital to permit the opening of more modern, viable stores."

and that (15A):

> "* * * Given the poor financial condition of Masters I at the time the merger was approved * * *"

cannot be said to be clearly erroneous.

C. The Valuation of Masters

(i) *By Louis Biblowitz*

At this point, the discussion should turn to the evidence of the valuation of Masters for the purpose of the merger presented to the District Court, first, as made by Louis Biblowitz and concurred in by the other appellees and, second, as made by the respective experts at the trial.

The Masters board of directors was well informed of and particularly sensitive to Masters' financial instability: its continual losses (Exh. BG, pp. 20, 21; Tr. 48, 107, 110, 113, 138, 149), its poor management, Haizen (Exh. BG, pp. 22, 23, 35, 36, 37; Tr. 95, 102, 110), the attempts to obtain new management (Exh. BG, pp. 37, 38), the attempts to find a buyer for Masters (Tr. 72, 105) and the fact that with only four stores, Masters could not exist (Tr. 113). They knew that something had to be done to salvage Masters (Tr. 874).

However, any thought that Masters might attract a buyer or investor was unrealistic and all efforts to find

someone interested in Masters failed (Tr. 528). Masters' counsel had asked Zayre Corp.'s counsel if Zayre Corp. were interested and he, and other directors, also asked if Rockower Bros.. the men's wear concessionaire at Masters in 1966 whose designee was a member of Masters' board, were interested (Tr. 76, 112, 529) as did others (Tr. 112); Louis Biblowitz had discussions with Billy Blake Stores (Tr. 783, 1937, 1938), with Flatbush Discount Stores (Tr. 786), with Times Square Stores (Tr. 787, 1403), with Grand Way (Tr. 878), with Hampton Sales (Tr. 786, 878), and with Friendly Frost (Tr. 254). Louis Biblowitz's offer was that he would sell control or half of control of Masters. This meant that the other party need not subject his entire company to the problems of Masters. Yet, not one of these entities was interested in associating itself with Masters (Tr. 783, 786, 878, 1937, 1938) except Times Square Stores which offered to merge with Masters by paying Masters' shareholders out of Masters' profits, if any. Kopelson agreed with Louis Biblowitz that Masters should reject this offer (39A; Tr. 880, 881).

As heretofore noted, in early 1966, Kopelson considered Masters trying the merger route in an attempt to solve its dilemma (Tr. 866) and sometime in the spring of 1966, Louis Biblowitz, after all conversations with others concerning a possible association with Masters had evaporated (Tr. 882), discussed with Mintz, the tax and accounting aspects of a possible merger between Masters and Lady Rose (Tr. 1491, 1492).

Kalish, Rubinroit & Co. at that time was the independent certified public accountants for Lady Rose and for Masters; they had become Lady Rose's independent certified public accountants as a result of the recommendation of Haizen, of Masters, in 1962 (Tr. 1694).

Mintz then prepared a schedule which included certain information from the books and records of Masters and Lady Rose, which included an estimate of Lady Rose that its after tax earnings for the year ended January 28, 1967 would be $500,000 (the prior year's net earnings were

$451,977) and which contained a valuation of Lady Rose at 10 times those estimated earnings and a valuation of Masters at 50% of its then book value of $2,500,000 (Tr. 1492, 1494; Exh. 3; Exh. AU). This schedule was not intended as a definitive valuation of the two companies and was nothing more than a preliminary and exploratory compilation of pertinent data to be considered by Louis Biblowitz and his brothers if they were to entertain a possible merger of Masters and Lady Rose (Tr. 1496).

From a survival point of view, it was essential for Masters to merge or combine with a financially strong viable company for it was in a financially precarious position, completely unable to show profits expected from its sales volume. The proposed merger with Lady Rose from Masters' viewpoint would permit (Exh. 25, p. 17):

(a) a combined corporate net worth of over $4,000,000, adequate to finance future expansion needs. This would include refurbishing and modernization of present stores, working capital for possible new operating units, credit approval for new lease commitments, etc.;

(b) combination with a successful retailer having a growing earnings experience, where in the first post-merger year Masters hoped to show significant profits for the first time in over ten years;

(c) an opportunity to develop a new, strong management team by attracting skilled personnel to a successful company;

(d) a broadening of the Masters product line base by moving into the important soft goods operation conducted; and

(e) a successful outlook for Masters. A long range prospect without expansion could only forecast the demise of Masters. The expansion and promotion of competitive retailers required similar expansion by Masters which was required either to keep up with its competition or ultimately fail.

And, as stated in Treasury Department letter of February 28, 1967 (125A):

> "In January 1963 Masters filed a petition in Chapter XI proceedings in the Bankruptcy Court of the Southern District of New York. A plan of arrangement was confirmed, whereby Masters was obliged to pay out, in periodic monthly installments, a portion of the debts it owed creditors. A creditors' committee was formed to help carry out the plan of arrangement.
>
> "However, Masters deficit became larger. A report made by independent certified public accountants showed that Masters had an operating deficit of $2,-705,583 since the adoption of the plan of arrangement. The creditors decided that Masters needed fresh capital assets to stop its deteriorating financial situation. Accordingly, the creditors' committee gave its consent for the merger described above."

While Louis Biblowitz was in favor of a possible merger between Lady Rose and Masters, his two brothers initially were not, especially Max Biblowitz, who was strenuously opposed to the idea. He felt that Lady Rose had been and was a money maker for more than 40 years with excellent management and backup people while Masters had been a consistent money loser with poor management. He was fearful that if Lady Rose's net worth was put into a losing company, like Masters, Lady Rose could be dragged down by Masters and foreclosed from available opportunities for, with its quality reputation, it was in an excellent position to acquire licensed departments. For example, in 1966, it added concessions in Bargain Town Stores (Tr. 1408, 1409). He saw no reason for Lady Rose to assume the responsibility for, and the liabilities of, Masters (Tr. 73, 267-70, 272, 533, 559, 760, 893, 1498, 1696).

Rubinroit, who was familiar with the respective financial conditions of both Lady Rose and Masters as a result of Kalish Rubinroit's role as independent certified public accountants for each of the companies, strongly advised against the proposal (Tr. 1696).

At this time, Lady Rose was considering a public offering of its stock and in connection therewith was consulting with Lawrence M. Rosenthal of L. M. Rosenthal & Co., underwriters and investment bankers (43A; Tr. 991, 995). The work of Rosenthal, a graduate of the Wharton School of Finance and Commerce and the Graduate School of Business Administration of Harvard University, involved the techniques of evaluation of companies (Tr. 1023, 1024).

When Louis Biblowitz mentioned to Rosenthal the possibility of a merger between Lady Rose and Masters, Rosenthal told him that a merger might complicate the public issue since Masters had recently gone through a reorganization which gave it a "clouded name" and that it would be more sensible to attempt to aid the Masters operation through means other than a merger. While he advised Biblowitz that there would be some disruption of Lady Rose's operations if Masters went bankrupt and that Lady Rose might gain Masters' tax loss carryforward, a public offering would be more beneficial to Lady Rose than a merger and that a merger would delay the public offering at least two years (43A, 44A; Tr. 1049-50).

Rosenthal further advised Biblowitz that any benefit to Lady Rose arising from its inheriting Masters' tax loss carryforward after a merger might be less important than Masters' "lack of earning power" which originally produced the carryforward (44A; Tr. 1050).

During the spring, summer and fall of 1966, discussions of a possible merger were conducted among the Biblowitzes, Rubinroit, Rosenthal, Mintz, Sassower and Ward (special counsel to Lady Rose) (44A; Tr. 1496).

These meetings concerned the economics of a merger, especially the accounting and tax aspects and the valuations to be assigned the two companies. Lady Rose's apparently healthy condition was contrasted with the less profitable condition of Masters during these meetings (45A; Tr. 1496-98).

At a meeting held on August 22, 1966 and attended by the Biblowitzes, Mintz, Rosenthal, Lady Rose's special

counsel and others, Rosenthal appraised a merged enterprise at $6,694,740, valuing Masters at 9.03% and Lady Rose at 90.97% (45A; Exh. X).

Rosenthal's valuations were based on his assumptions that, after a merger, Masters would not go bankrupt, the merged company would have available to it Lady Rose's earnings in order to take advantage of so much of Masters' tax loss carryforward as equalled those earnings and that Lady Rose could continue to operate its concessions in the Masters' metropolitan stores (46A; Tr. 1087).

On or about October 5, 1966, Mintz prepared a data sheet showing a valuation of Lady Rose at $6,000,000 and of Masters at varying amounts between $650,000 and $800,000. Lady Rose's equity in the proposed entity would accordingly be between 86.147% and 88.847% (46A; Exh. AG; Tr. 1499).

Louis Biblowitz then made the decision to value Masters at somewhere between $750,000 and $800,000, or $1.65 and $1.76 per share for purposes of the merger (47A; Tr. 1432). Thus, contrary to appellants' assertion, Louis Biblowitz did not arbitrarily pick a value of $1.71 per share as the value of Masters shares for the purpose of the proposed merger (Br. p. 24). The price of $777,000 was higher than the valuation made by Rosenthal on August 22, 1966 of $618,350.

His proposal was presented to Masters' board of directors which considered it at its meeting on October 31, 1966 which meeting was then adjourned to November 7, 1966 to permit further deliberation (112A-122A).*

(ii) ***By Appellees' Expert***

Appellees' expert was Martin Whitman who has a bachelor's degree, cum laude, from Syracuse University, a master's degree from the New School, has taken graduate work at Princeton University, New York University, New York

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* As a result of these meetings certain modifications were made to his proposal (118A, 119A).

Institute of Finance and who is a certified chartered financial analyst. His field for his master's degree and graduate work was economics and finance. At trial, he was a lecturer in money and financial institutions at Yale University (Tr. 1750) and had lectured in the field of finance at the Wharton School and Princeton University (Tr. 1752). Since 1950, he has been in various aspects of the financial community (Tr. 1750), after a while, in the field of acquisitions and mergers (Tr. 1751). In the words of appellants' expert (Tr. 1269):

> "Q. Are you acquainted with Mr. Martin Whitman?
> "A. Yes, sir.
> "Q. Do you know his reputation?
> "A. I think very highly of him, sir."

In valuing Masters, Whitman found that Masters was in need of a rescue operation; its credit standing was poor; it was reporting losses and there was no indication that the operation of the metropolitan stores could be made profitable without a considerable investment. Management was chaotic with the Biblowitzes having no experience in hard goods; the physical plant, i.e., the stores, was not adequate, the advertising coverage was not good; there was uncertainty of what would happen in the absorption of the Florida overhead and was of the opinion that to develop earning power in Masters so that the central overhead could be spread over more operations, a huge infusion of money was required (64A; 1777-1784).

The price earnings ratio method of valuing Masters could not be utilized because Masters had none (Tr. 1854) and he, therefore, used what he considered to be a meaningful market for the Masters stock (199A).

To enable Masters to continue to operate its business and to comply with the condition in the Plan of Arrangement that an unsecured subordinated loan be obtained by Masters, principally Lady Rose and other purchasers of the majority stock interest in Masters purchased subordinated loans from Masters for $283,000. The sub-

ordinated loans provided that the lenders had the right to purchase shares of Masters common stock as follows:

> (a) Three shares of the common stock of Masters, par value $1.00 per share, for every one dollar of loan extended at a price of $1.25 per share if purchased on or before December 27, 1966;
>
> (b) Three shares of the common stock of Masters, par value, $1.00 per share, for every one dollar of loan extended at a price of $2.00 per share if purchased on or before December 27, 1968;
>
> (c) Upon the exercise of the option, such portion of the sums loaned, together with accrued interests as required, might be applied to any sums due Masters by reason of the exercise of said option (30A; 88A; Exh. 2, p. 8).

Each of the purchasers of the $283,000 subordinated loan had the right until December 27, 1966, to purchase Masters common at $1.25 per share. These people could have purchased an aggregate of 849,000 Masters common at $1.25 per share payable in the aggregate by the surrender of the $283,000 subordinated notes to be valued at par, plus accrued interest, and the payment to Masters of a maximum of $778,000 cash assuming there was no accrued interest. After December 27, 1966, the exercise price was stepped up by sixty per cent (60%) from $1.25 to $2.00. Thus, if an investor attributed a value of more than $1.25 (in subordinated notes and cash) to Masters common stock, he would, in the economic sense, have "been forced" to exercise before December 27, 1966 (200A).

The fact is that virtually all these investors—who would have accounted for sixty-one per cent (61%) of the combined Masters common stock capitalization if they exercised their warrants (seventy-one per cent (71%) including the Biblowitzes holdings)—voluntarily surrendered their warrants (200A).

As a result, Whitman valued the Masters common stock at less than $1.25 per share, or under $489,000 for the

391,103 shares, that is, the equity of Masters not owned by the Biblowitzes (199A; 200A; 65A).

In reaching that valuation, he considered that at the time of merger, Masters had a tax loss carryforward as follows:

Year of Operating Loss	*Carry-forward Loss*	*Date of Expiration*
4/30/63	$274,045	1/31/68
5/2/64	$2,200,423	1/31/69
5/1/65	$32,304	1/31/70
1/31/66	$72,077	1/31/71
1/31/67	$800,000 (est.)	1/31/72
	$3,378,849	(35A)

and that in order to utilize the largest part of the tax loss carryforward, Masters would have to realize a profit of $2,474,468 (35A) which it never had done in all of its history (Tr. 408).

In this connection, Kopelson had pointed out to the Masters directors that years were elapsing in which the tax loss carryforward was not being utilized because Masters was incapable of generating profits to offset against the carryforward and that if this continued, the tax loss carryforward would expire without being used. In the posture of Masters in October and November of 1966, with no prospect of profits, Kopelson's conclusion was that Masters could not utilize the tax loss carryforward (Tr. 897; 55A, 56A; Tr. 54, 101, 132, 360).

Whitman noted that in a merged company these earnings had to be achieved relatively rapidly in a situation fraught with uncertainties (e.g., all four surviving Masters stores suffered operating losses in the fiscal year ended January 28, 1967 with the aggregate operating loss of $360,000 based on audited figures) and that there was nothing in the historic pattern of net income to suggest such results might be even remotely achievable. Page FS-17 of the Proxy Statement showed pro-forma combined summary of net income as follows:

Fiscal Year	*(000) Profit or (Loss)**
1963	($688)
1964	252
1965	505
1966	420

* Before Special items and before taxes (204A).

In Whitman's opinion, the value of Masters' tax loss carryforward to Lady Rose as of the time of the merger was slight since (1) Lady Rose would also have to assume the obligations of Masters, including the obligations to the Creditors' Committee, (2) it was uncertain whether a combined Masters-Lady Rose operation would enjoy sufficient profits to fully utilize the tax loss carryforward, (3) Masters' tax returns had only been reviewed through April 30, 1963 and, consequently, the size of the tax loss carryforward could only be estimated and (4) under Section 269 of the Internal Revenue Code, the Internal Revenue Service might contest use of the tax loss carryforward by the merged company (65A, 66A).

He testified that he had no knowledge of any situation where a dollar figure had been placed on a tax loss carryforward and felt that the only conceivable place that it could properly be done would be in a clean shell transaction, i.e., where the acquirer does not assume the encumbrances of the acquiree (Tr. 1790). And, Rosenthal also testified that he knew of no way to assign a value to a tax loss carryforward and that he knew of no instances in which a value had been assigned a tax loss carryforward (46A; Tr. 1050-51). Appellants attempt to avoid the impact of his testimony by suggesting in a footnote at page 19 of their brief that Rosenthal, at the time of his testimony, was under the influence of Louis Biblowitz because he was Masters underwriter in 1969, was a director of Masters and his company had bought 55,000 shares of Masters stock in 1969. It is submitted that these facts do not.

Again, the District Court's finding that appellees acted fairly in appraising Masters at $770,000 (26A) was not clearly erroneous nor its finding that the aforementioned factors made it reasonable for the Masters board to conclude that a value should not be placed on the tax loss carryforward (27A).

(iii) *By Appellants' Expert*

Appellants' expert was Leonard Marx, a securities analyst (59A), who valued Masters at $3,000,000 (154A). With all due respect to Marx, his opinion was based on such a lack of knowledge of material facts and subject to so many errors that it was not entitled to the same weight as the opinion of appellees and their experts.

He stated (174A):

> "The Masters' shareholders, if they had been given the proforma numbers without the losses of the disposed Miami units, would have felt the stock was now a good speculation; the financial condition was solid; the losses had been stemmed * * *"

He could not be more wrong; the remaining metropolitan stores lost some $360,000 for the year ending January 31, 1967 and the company's working capital was depleted down to $1,100,000 by that date. The company's financial condition was anything but solid, as Kopelson testified (Tr. 872), and the losses had not been stemmed, only momentarily reduced.

He opined (165A):

> "I feel that the elimination of the Miami units, change in management, renegotiation of leased department leases, and strong financial condition of Masters after the Miami sale and cash received from Zayre's, indicates at least a breakeven operation currently, and a projection of at least $400,000 pre-tax once these changes took effect."

However, his estimate of $400,000 pre-tax earnings for Masters was based on views that (a) gross profit margins

would be improved to a normal margin of cost of goods to sales ranging from 71% to 76%; (b) that rental rates would be improved; (c) that Masters had a new operating management presumably experienced in hard goods; and that (d) Masters had a strong financial condition after the sale of the Miami stores (164A, 165A). These views are erroneous. First, normal cost of goods sold percentages for hard goods operations are well above the norms cited by Marx (Tr. 1838, 1839).

Second, Marx was in error concerning Masters' rental rates for years prior to 1967 though he had thought previously these were higher (Tr. 1299-1303). Marx' calculations of average occupancy costs for other companies were either erroneous or incomplete (Tr. 1829-31; 1898).

Third, Masters did not obtain new hard goods operating management until a year after the merger was consummated (Tr. 211, 2112, 2115).

Fourth, Masters' financial condition was precarious after the sale of the Florida stores. Marx failed to appreciate that the bulk of the proceeds had to be used to pay Florida creditors (Tr. 1836, 1950-56). There is no mention by Marx of the lack of quality of Masters' inventory or Masters' relationships with its trade creditors, both of which adversely influenced Masters' financial position even though not reflected in accounting numbers.

In valuing Masters, Marx did not know that the metropolitan stores were at a serious commercial disadvantage (Tr. 1339-1342). He admitted that he attached no value in his appraisal to the Masters management which was admittedly bad for it would have hurt his appraisal (Tr. 1345, 1348, 1351).

Marx admitted that he had no expertise in retail operations but that he was a security analyst and not particularly knowledgeable about retail inventories (Tr. 1326-28). He relied basically on general accounting numbers and made no comments about the state of Masters' inventories, or its relationships with creditors. Indeed, he did not know that, before the sale, the Florida stores were absorbing part

of the central overhead (Tr. 1343). After the merger, he had no knowledge of what portion of the central overhead of the Masters Division might have been absorbed through services performed for the Masters Division by the Lady Rose Division (Tr. 1344).

In concluding that the metropolitan stores would break even for the year ending January 28, 1967 (164A), Marx relied on Kopelson's forecasts, and did not know that all of them in the past had proved unreliable (Tr. 1352, 148, 278, 527, 845, 862-64, 873, 1438).

At page 25 of their brief, appellants urge that every contemporaneous acquisition of an entire company analyzed for market price showed that book value or more was obtained. However, Marx never compared the Masters-Lady Rose merger with the one type of transaction that would be comparable, where the de facto acquirer, a viable profitable business whether lessor or lessee, acquired another company, whether lessor or lessee and where the acquired company was (a) a Chapter XI company and unprofitable and where (b) the acquiring company assumed all the obligations and encumbrances, on and off balance sheet, of the acquired company. For example, Marx contended that Spencer Shoe acquired 9 Floyd Bennett units which had lost $288,000 in the year of acquisition and had a negative working capital of $1,016,000 for two times its book value and had its debt of $1,400,000 guaranteed by Spencer Shoes (Br. pp. 26, 27). But, as Whitman testified, this was not comparable with the Masters-Lady Rose situation (Tr. 1791, 1792):

> "A * * * Let us contrast this, for example, with Spencer Shoe and Floyd Bennett, where Mr. Marx said Spencer Shoe assumed all the obligations. Spencer Shoe would acquire Floyd Bennett only in a subsidiary and only assume—only guarantee specific debts. This was not the case here. You bought all the history, you bought the Creditors Committee, you bought whatever lawsuits could come in, you bought whatever state inventory there was—it was all your obligation.

"Q. In other words, here Lady Rose had to assume all of the Masters obligations, correct?

"A. Yes. Put otherwise, it had to give 100% of its credit standing to Masters in order to use it, you have to subtract that from any potential kind of valuation."

The reference at page 26 of appellants' brief to Marx' statement of Marrud selling in the market at 1.3 times its book value does not deal with the acquisition of Marrud by a viable company which assumed all of Marrud's liabilities as did Lady Rose with Masters. And, the reference at the bottom of page 26 to the sale of Marrud at 1.3 times book value is simply a misstatement. Marx was citing Marrud for the fact that its stock was selling at 1.3 times book—not that someone bought the company for that price (157A; Tr. 1218). And, he did not refer at all to the fact that Marrud was so purchased, rather only that its inventories were purchased (Tr. 1837). Thus, Marx was not using comparable market data in valuing Masters.

In addition, the Marx appraisal was replete with statistical and arithmetic errors (Tr. 1829, *et seq.*).

Marx attempted to value the tax loss carryforward by following an article written on the subject (Br., p. 19). He acknowledged that the article itself stated that (Tr. 1362):

"Q. Substantially nobody knew any thing about how to value a tax loss carry forward, isn't that right?

"A. I think that's what the article said."

And testified (Tr. 1372, 1373):

"Q. * * * Do you know of any single case in which a dollar value was placed on a tax loss carryforward?

"A. No, sir.

"Q. Have you ever heard of that being done?

"A. Not that I can recall.

"Q. As far as you know, you are the first man who has ever placed a dollar value on a tax loss carryforward, is that correct?

"A. I think that is impossible.

"Q. But you don't know of anybody else; is that right?

"A. That's right."

Small wonder that the District Court wrote (26A):

> "With respect to tax loss carryforward of Masters I, to which plaintiffs' expert assigned a value of at least $800,000, the court finds that it was reasonable for Masters' board to have assigned no value to the carryforward."

Appellants at pages 20 *et seq.* of their brief attempt to "expose the baselessness" of Whitman's opinion on the subject of valuing Masters' tax loss carryforward. For example, they argue that there is no substance to Whitman's position that it was uncertain whether a combined Masters-Lady Rose operation would enjoy sufficient profits to fully utilize the carryforward (65A) because:

(1) Masters' accountants advised the board of directors that:

"* * * assuming that the pattern of performance of Lady Rose continued in the projected amount of $600,000 annual earnings, then the aforementioned carryforward loss would enable all earnings of the merged company to be after tax earnings to the full extent of said loss"; and

(2) Whitman was taking an inconsistent position, i.e., in valuing Lady Rose he assumed earnings of $600,000 but in evaluating the tax loss he raised the question whether the combined enterprise would enjoy sufficient profits to fully utilize the carryforward.

The statement attributed to the accountants is simply incorrect. As noted hereinbefore, to fully utilize the tax loss carryforward available to January 31, 1969, the combined enterprise would have to show a pre-tax profit of $2,474,468. If Lady Rose earned $600,000 after tax, or approximately $900,000 pre-tax, for two years, it would leave the combined enterprise short some $674,468 since based

on Masters prior performance it could not be expected to show any profits.

And, there is nothing inconsistent about Whitman's position. While he assumed after-tax earnings of $600,000 to value Lady Rose, there was nothing to indicate to him that such earnings would not be offset, in whole or in part, by Masters' losses. As he testified, if he were to assume a great probability that the merged company would use the full tax loss carryforward, Lady Rose would have been undervalued if its value were based on an annual after-tax $600,000 earning power (Tr. 1795) and should have been valued at between $10,000,000 and $12,000,000 (Tr. 1867).

Appellants also argue that Whitman erred when he considered that after the merger Lady Rose would have to assume obligations to the Masters' Creditors Committee because that indebtedness was being reduced and Masters' working capital was in excess of $1,800,000 as at July 31, 1966. The trouble with their argument is that these reductions were not coming from earnings or borrowings but rather from working capital which had already been depleted from over $3,000,000 after the Plan of Arrangement was adopted and which continued to fall to just above $1,000,000 by January 31, 1967.

Appellants argue at pages 17 *et seq.* of their brief that:

> "Under the original plan of merger* the Biblowitzes were to receive less than 80% of the common stock with the remaining Masters stockholders to receive approximately 20% of the Masters' common stock, because for every 1% of the common stock above 80% received by the Biblowitzes, 5% of the Masters' tax loss carryforward would have been lost (210A). But thereafter the accountants and lawyers for the Biblowitzes conceived a technique which would permit the Biblowitzes to retain the equivalent of 90% of the equity of Masters without forfeiting any of the Mas-

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* There was no "original plan of merger" but rather a preliminary and exploratory compilation of pertinent data (see p. *supra*).

ters' tax loss carryforward (52A). This was accomplished by issuing 1,750 shares of 5% non-cumulative non-voting, preferred stock of Masters to Lady Rose that was convertible into 1,750,000 shares of common stock of Masters on February 1, 1973. The non-voting preferred stock did not reduce the Masters' tax loss carryforward."

This is simply not so. The evidence discloses the following:

Based upon a valuation of $6,000,000 for Lady Rose and between $750,000 and $800,000 for Masters, the Lady Rose ownership of the proposed merged entity would be approximately 87.7% and Masters' shareholders' ownership approximately 12.3% (47A; Tr. 1502). In addition, based upon these valuations, and assuming that the proposed merged company could generate pre-tax profits against which the tax loss carryforward could be used, Kalish Rubinroit's figures on October 5, 1966 contemplated a maximum utilization of between 61.275% and 63.965% of the tax loss carryforward (Exh. AG, Tr. 1503) because for each percentage point under 20% of the proposed merged company owned by the Masters' shareholders, 5% of the available tax loss carryforward would be lost (47A; Tr. 1493).

These figures contemplated that the 9% subordinated notes issued by Masters would be converted into shares of common stock of the proposed merged entity (47A; Exh. AG; Tr. 1500).

The final percentage of Lady Rose ownership of the merged company of 89.95% resulted from the fact that the 9% subordinated notes were not converted into common stock of the merged entity and also from the redemption by Masters of 44,000 shares of its stock owned by Haizen (48A; Tr. 1518-1521).

Subsequent to October 5, 1966, one of the professionals advising the Biblowitzes proposed using another class of stock with no voting rights in the merger to enable the proposed merged entity to utilize 100% of the tax loss

carryforward rather than the 61.275% to 63.965%, provided the proposed merged entity had profits to offset against Masters' prior losses (48A; Tr. 1505-06).

Thus, the technique referred to by appellants did not permit the Biblowitzes to increase their equity in Masters in a merger; rather, it permitted the proposed merged entity to utilize, if possible, a greater percentage of the available tax loss carryforward.

Appellants suggest that the District Court erroneously inferred that the working capital and net worth of Masters on July 30, 1966 was greater than that prior to the adoption of the Plan of Arrangement when majority control was purchased for $1.15 and, therefore, erroneously concluded that the price in the merger of $1.71 was fair (Br. p. 38). This, claims appellants, stems from the fact that the District Court found (29A) that the purchase occurred on April 11, 1963, prior to the adoption of the Plan and found (31A) that the price was $1.15 per share (31A) and that:

> "* * * The current assets on April 30, 1963, shortly after the purchase, were $5,315,974; current liabilities were $2,068,184 (Exh. AH, p. 3); its working capital was $3,247,790 and its net worth was $2,718,092 (Exh. AH, p. 3). * * *"

Page 3 of Exhibit AH consists of the consolidated balance sheet and pro forma consolidated balance sheet (giving effect to the confirmation of the Plan). It is obvious that the District Court was aware that the quoted figures were those applicable after adoption of the Plan. No company whose current assets exceed its current liabilities by some $3,300,000 with a working capital of approximately that amount would be in Chapter XI.

As stated in *Nanfito* v. *Tekseed Hybrid Co.*, 473 F.2d 537 (8th Cir. 1973); (p. 541):

> "Valuation is a question of fact, and its determination by the trier of fact should not be disturbed unless clearly erroneous * * *."

Similarly, in *Laurenzano* v. *Einbender,* 448 F.2d 1 (2d Cir. 1971), this Court stated (p. 7):

> "Plaintiffs argue, however, that because of the existence of the restrictions and the fact that the National shares were unlisted, the value of those shares should have been specially discounted. It is true that generally, restricted securities cannot as readily be sold in the public market as freely salable securities. The fact remains, however, that Bargain Town's directors recognized the need to acquire earnings and improve management, problems which they could reasonably conclude might be helped by the acquisition of G.E.S. Though perhaps some discount should have been applied, given these facts concerning the special benefits to Bargain Town from the purchase of G.E.S., the discount rate need not be as steep as plaintiffs argue it should be—more than 25%. A discount of up to 14% could be applied to the National stock received in exchange for G.E.S. and the value of G.E.S. would not fall below $2.1 million, the actual purchase price. In any case, the existence of these special values to Bargain Town in the business context of the purchase indicates that plaintiffs are incorrect in arguing that two contemporaneous sales of G.E.S. stock mechanically determine the proper sale price to be paid by Bargain Town. Additionally, *there existed two appraisals of G.E.S. by what Judge Dooling found to be independent appraisers which placed the value at a minimum of $2.1 million, a figure which Judge Dooling found to be reasonable and accurate. Though Judge Dooling found and defendants admit that neither report is free from error, we cannot say that the finding that such appraisals were not inaccurate is clearly erroneous.*
>
> "The findings of fact and conclusions of law reached by the district court on careful consideration after an extended trial are supported by the record. The judgment is affirmed." (Emphasis supplied)

So, too, are the findings and conclusions of the District Court in the instant case.

The District Court's Findings of the Value of Lady Rose Were Not Clearly Erroneous

A. The Fiscal and Operational Conditions of Lady Rose

Lady Rose's financial position was much stronger than that of Masters. From February 29, 1964 to August 31, 1966, its working capital had risen from $835,701 to $1,821,-070; its net worth had risen from $1,447,469 to $2,532,200; and its retained earnings had risen from $1,227,394 to $2,312,125 (39A; Exh. AQ).

Its total net income steadily rose (40A):

Fiscal Year Ended	*Total Net Income*	
2/29/64	$205,397	(107A)
2/28/65	$301,262	(107A)
2/28/66	$451,977	(107A)
11 mos., 1/28/67	$527,000	

The company was tightly operated by the three Biblowitz brothers (Tr. 1451, 1452), was profitable and healthy (Tr. 1498) with, even according to appellants' own expert, excellent management (Tr. 1252) and possessed an excellent reputation (Tr. 271). Lady Rose and its predecessor had been engaged in the retail sale of ladies soft goods and apparel for 45 years, every year of which was profitable (Tr. 236, 237).

While Lady Rose's income was steadly increasing, its dependence on income from Masters lessened (40A; Tr. 1772).

Lady Rose Income

Fiscal Year Ended	*Total Net Income*	*From Masters Metro-politan Stores*	*From Masters Florida Stores*	*% From Masters*	
2/29/64	$205,397	$59,121	$ 8,212	33.2	(Exh. AO)
2/28/65	301,262	67,971	27,379	31.6	(Exh. AP)
2/28/66	451,977	79,220	63,621	31.7	(Exh. AU)
6 mos. end 8/31/66	331,491	48,710	44,618	28	(Exh. 136)
11 mos. end 1/28/67	527,000	84,000	47,000	24.8	(Exh. 133)

And, from year ending February 29, 1964 to eleven months ending January 28, 1967, Lady Rose income from Masters' metropolitan stores dropped one-half; it went from 29.3% (February 29, 1964) (Exh. AO) to 22.6% (February 28, 1965) (Exh. AP) to 17.5% (February 28, 1966) (Exh. AU) to 14.7% (August 31, 1966) (Exh. 136) to 15.9% (January 28, 1967) (Exh. 133).

During the same period, Lady Rose income from Masters' Florida stores increased from 3.9% (February 29, 1964) (Exh. AO) to 9.0% (February 28, 1965) (Exh. AP) to 14.2% (February 28, 1966) (Exh. AU), then to 13.7% (August 31, 1966) (Exh. 136). Nonetheless, when it came to the decision whether the Florida stores of Masters should be closed, the Biblowitzes, notwithstanding the increasing Lady Rose percentage of profits in these stores, voted to close them, evidencing the fact that by mid-1966, the Masters' stores played a minor role in Lady Rose's income (Tr. 1773) and that Lady Rose believed business derived by it from departments in Masters was readily replaceable (Exh. AZ, p. 6).

And, it was (Exh. 16, p. 10):

	Fiscal Year			
	1965	*1966*	*1967*	*1968*
Units at beginning of period	16	15	16	18
Units opened	1	3	4	2
Units closed	2	2	2	—
Units at end of period	15	16	18	20

B. The Valuation of Lady Rose

(i) *By Louis Biblowitz*

Sometime in August, 1966, when the Biblowitzes ascertained that the then Lady Rose first six months operations would show a net profit of $327,000, with the historically better six months to come, they forecast that Lady Rose would earn $600,000 after taxes for the twelve months ending January 31, 1967 (45A; Tr. 452, 1765, 1766, Exh. 3, p. 3). Included in this estimate were the profits from the Florida stores where Lady Rose had had concessions and

the profits from new concessions which Lady Rose had received in 1966 (45A; Tr. 804). According to Whitman, if the Lady Rose estimate had been based on the same seasonal pattern that had prevailed the year before, estimated net earnings for the year to end February 28, 1967 would have been $898,000. Thus, by using the $600,000 estimate, Lady Rose had, in fact, taken into account terminated operations as well as the possibility of adversities (194A, 195A; Tr. 1844). Lady Rose, for the purpose of the merger, was valued at ten times that amount, or $6,000,000 (47A).

In August, 1966, Rosenthal valued Lady Rose at $6,694,740 (45A; Exh. X).

(ii) ***By Appellants' Expert***

Whitman's appraisal of (64A, 193A):

> "* * * a fair and reasonable value for the Lady Rose equity would be in a range between $5-$6 million based on a price earnings ratio of approximately 8 to 10 times conservatively estimated earning power at the time of approximately $600,000 per annum."

He testified that the eight to ten times multiple was based on the index of "retail" companies filing annual reports with the Securities and Exchange Commission as of December, 1966. Of the companies within this index, the average multiple was 9.1 (64A; Tr. 1885).

According to Whitman, in valuing a business, earning power, i.e., the ability to be profitable in the future is more important than reported earnings, i.e., a record of what had happened historically (195A). If he were to have made a more conservative estimate of annual earnings of Lady Rose of $480,000 as did appellants' expert (Br. p. 45), Whitman's multiple would have been higher than eight to ten. And, he was of the opinion that where a company like Lady Rose opens and closes stores as a normal part of its business, one does not take out discontinued operations without considering new stores that are to open—as

did Marx (161A). He testified (Tr. 1879, 1880):

"Q. Now, if we took off the * * * if we just took off the Florida units and came down to 480,000 as an actual continuing operation of Lady Rose for that year, and we used your multiple of eight times, you said eight to ten, but suppose we used eight times the 480, then you would have a value re Lady Rose of $3.840 million?

"A. Gee, I am sorry, Mr. Bender. You so completely misunderstood my testimony.

"Q. I guess I did.

"A. Yes. First of all, if I made a more conservative estimate I would have ended up—because I am really interested not so much in what they report for a year but what this business can earn, if I in fact would have reduced earnings to such a conservative level I would have applied a far higher multiple. Second, I don't know how many times we are going to repeat that my belief that opening-closing stores are a normal recurring part of chain store operations like Lady Rose, and one does not first take out discontinued operations and make no allowance for the fact that new stores are coming on stream. This is especially true in a company like Lady Rose with a known active expansion program.

"Q. Sir, in other words, you say if the earnings were less you would just use a higher multiple then, is that right?

"A. That's right. Not just, if the earnings are less without reason. The lower earnings do not reflect lower earning power. One would apply a higher multiple. It is done every day. * * *"

Thus, when the actual earnings for the eleven months ended January 28, 1967 were $527,000 instead of the projected $600,000, there was no reason for Whitman to reduce his valuation to $4,800,000 from $6,000,000 (Tr. 1880).

Appellants argue that Whitman's approach was improper because he did not fit any market data in his report

(Br. p. 41). However, as he testified (Tr. 1897):

> "Q. Isn't it a fact that you haven't put any place any market data, isn't that so?
>
> "A. Well, eight to ten times, you see is basically based on a market and the answer is I talk about users, basically as we talked, and I thought you agreed, we were valuing the business rather than a stock. We were basically valuing businesses rather than stocks. I don't know that all that stock market data, if I had used it, would have been particularly fruitful.
>
> "Q. I thought you were here as a research analyst and with some familiarity with the values that the market placed on businesses?
>
> "A. No, I thought I was here as a financial analyst that would look at what the reality of the situation was and appraise it in light of that, not as a stock where somebody was buying and selling a thousand shares, but rather a business."

Whitman considered that Lady Rose derived income from Masters but felt that if it were eliminated therefrom Lady Rose could obtain business elsewhere (Tr. 1921). Indeed, Lady Rose had an active expansion program; it had opened stores in Bayomon and Carolina and possibly a third was to open on Long Island (Tr. 1923). That a certain inventory write down was required as a result of opening new stores does not change th fact that new stores were opened (Cf. Br. 43). Nor does the fact it had the same number of stores in the beginning of fiscal 1967 as it had in the beginning of fiscal 1965 demonstrate the lack of an expansion program (Cf. Br. 43); indeed, it does show such program for without it there would have been a lesser number since five were closed in fiscal 1967 (Br. p. 43). The fact is that over a five year period it had an expansion of 47% (Tr. 1925).* By virtue of the foregoing, the Dis-

* Further evidence of this expansion is the very substantial rise in Lady Rose's net income i.e., from $229,254 for the fiscal year ended February 28, 1963 (105A) to $527,000 for the eleven months ended January 28, 1967 (Exh. AG).

trict Court properly found (27A):

> "Mr. Marx's argument that the benefit to Lady Rose of retaining their concessions in the Masters stores should have been subtracted from Lady Rose's value was given little weight, in view of Lady Rose's large number of concessions, its economic strength and presumed ability to find other concessions."

Appellants' argument (Br., p. 40) that Zayre's acquisition of Hardline Distributors at nearly 6.7 times earnings supports Marx's multiple of 7 x Lady Rose's earnings also misses the point. As Whitman testified (Tr. 1921):

> "A. * * * It goes the same way as we talked about Hardline, the earnings deserved a low multiple because 70 percent of the stores, the leased departments were in Zayre's Department Stores and they were in a poor negotiating position with Zayre's."

The further references by appellants to the price of shares of stock of other companies is not dispositive of the issue of the value of Lady Rose for it is as Whitman testified the value of the business that is in issue, not the value of shares of stock.

Finally, Whitman also considered the relative strengths and weaknesses of the landlord-concessionaire positions noting, *inter alia,* the concessionaire's strength over a landlord with poor stores, weak merchandising, bad advertising umbrella and unable to attract its own operating management. He also noted that concessionaries are able to go into stores with smaller investments and have more flexibility than landlords (Tr. 1771).

(iii) *By Appellees' Expert*

Marx valued Lady Rose at $3,350,000 (162A), just 10% more than his $3,000,000 valuation of Masters.

He projected net income of Lady Rose for the year ending in early 1967 at $500,000 by eliminating Lady Rose income derived from the Masters Florida stores of the

opinion that Lady Rose did not have an active expansion program although in the period 1965-1968, its total number of stores increased one-third (from 15 to 20), opening ten new stores in that period which started with a total of 16 (Exh. 16, p. 10). From this, he deducted additional rent which he felt Lady Rose would pay to Masters of $20,000 per annum, arriving at a figure of $480,000, which he multiplied by 7 to reach the $3,350,000 (162A).

His conclusion could not have been more wrong. Adopting appellants' own argument (Br. pp. 62, 63) that one should look to the actualities to test an expert's appraisal, we find the following. The operating income for the merged company for the year ending January 27, 1968 was $1,495,300 and for the year ending February 1, 1969 was $2,505,372 (Exh. 16, p. 6). This profitable operation resulted primarily from the profits of Lady Rose (Exh. 16, p. 8). These profits totalled $1,505,993 for the first of the two years (Exh. D, last page) and for the second year, Lady Rose's profits were $1,940,004, its and its subsidiaries' profits were $2,145,384 (Exh. C, last page). Again, the District Court's finding (27A):

> "* * * that the Masters I board acted reasonably in assigning a value of $6,000,000 to Lady Rose. * * * [and] the report and testimony of defendants' expert, Mr. Whitman, more persuasive than those of plaintiff's expert, Mr. Marx."

cannot be said to be clearly erroneous.

The District Court's Findings That The Terms of The Merger Were Fair to the Masters' Shareholders Were Not Clearly Erroneous

The District Court found that the terms of the merger were fair to the Masters shareholders (24A). Based upon the evidence of the relative positions and valuations of the two companies as heretofore discussed and Whitman's opinion that it was not only fair but highly beneficial to the Masters' shareholders (192A) considering, *inter alia,*

the financial and business histories of both companies, their financial positions and management situations, the potential of the merged enterprise and an evaluation of the benefits and encumbrances, tangible or intangible, which each would bring to the merged enterprise (63A, 192A), that finding was not clearly erroneous.

The District Court's Findings That There Were No Material Misrepresentations or Omissions in the Masters' Proxy Statement Were Not Clearly Erroneous

A. Legal Principles

Whether the Masters' merger proxy statement contained material misrepresentations or omissions is a question of fact. *Knauff* v. *Utah Construction & Mining Co.*, 408 F.2d 958 (10th Cir. 1969).

In *Gerstle* v. *Gamble-Skogmo, supra,* this Court considered the standard of materiality in light of the Supreme Court's opinion in *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375 (1970) and reaffirmed "that the basic test of materiality is whether 'a reasonable man *would* attach importance [to the fact misrepresented] in determining his choice of action in the transaction in question' " (p. 1302) . . . [and] "whether 'taking a properly realistic view, there is a substantial likelihood that the misstatement or omission may have led a stockholder to grant a proxy to the solicitor or to withhold one from the other side, whereas in the absence of this he would have taken a contrary course' (Emphasis supplied)" (p. 1302).

The Court further wrote (p. 1302):

> "* * * While the difference between 'might' and 'would' may seem gossamer, the former is too suggestive of mere possibility, however unlikely. When account is taken of the heavy damages that may be imposed, a standard tending toward probability rather than toward mere possibility is more appropriate. We therefore adhere to this court's formulations of the test of materiality quoted above."

Materiality is a "matter to be determined upon all of the relevant facts and circumstances". *Crane Co.* v. *Westinghouse Air Brake Co.*, 419 F.2d 787, 800 (2d Cir. 1969) and is a question to be determined by the trier of the facts. As this Court wrote in *Radiation Dynamics, Inc.* v. *Goldmuntz,* 464 F.2d 876 (2d Cir. 1972) (p. 888):

> "* * * Moreover, as to RDI's suggestion that knowledge of an unfolding merger transaction becomes material information at any one of the suggested theoretical stages, we can only point out, as we did in SEC v. Texas Gulf Sulphur, supra, 401 F.2d at 849, that such 'materiality' must be determined on a case-to-case basis according to the fact pattern of each specific transaction. For the determination of whether information is material or, alternatively stated, of whether such information would have affected the actions of a 'reasonble man' the jury is the appropriate body."

This Court has recognized that "full disclosure does not require the inclusion in a proxy statement of every relevant detail of a company's operation." *Crane Co.* v. *Westinghouse Air Brake Co., supra.*

In *Abramson* v. *Nyquist,* 312 F.Supp. 519 (S.D.N.Y. 1970), the Court wrote (p. 524):

> "* * * Defendant-directors were obligated to make a full and fair disclosure of those facts which a stockholder would need in order to make an intelligent and informed decision on Gulton's proposed purchase of its shares. They were not, however, required to present to the Gulton shareholders all the arguments that could be made against their recommendations. The proxy provisions of Rules 14a-9 and 10b-5 are aimed at disclosure of all material facts, not at ensuring an exhaustive, dispassionate, and evenly balanced presentation of conflicting interpretations of the facts given. It is of course possible to present facts in a manner calculated to confuse and deceive, e.g., Norte and Co. v. Huffines, 304 F.Supp. 1096, 1106 (S.D.N.Y. 1968), but absent some evidence of unfairness or lack of good

faith in the mode of presentation, it is enough if proxy material sets forth all the facts necessary to enable a reasonably intelligent stockholder to make his own informed decision. * * *''

B. The Claimed Material Omissions and Misrepresentations

With this background, we now turn to appellants' claimed material omissions and misrepresentations, and submit that each finding by the District Court with reference thereto is not clearly erroneous.

1. *The Biblowitz' Control of Masters*

2. *Louis Biblowitz Fixed the Values of Masters for the Merger and What It Was to Get in the Merger*

Appellants contend that the proxy statement failed to disclose that Masters was controlled by the Biblowitz family (Br. p. 3) and that Louis Biblowitz set the values for Masters in the merger (Br. p. 4).

The District Court found that each of these facts was adequately disclosed (16A-17A). The discussion of these issues is combined because they were both disclosed in the following portion of the proxy statement (87A):

> ''Interests of Directors and Officers and Their Associates in the Proposed Merger
>
> ''Louis Biblowitz, Chairman of the Board of Directors of Masters, Inc., Max Biblowitz and Joshua Biblowitz, directors of Masters, Inc. are stockholders, directors and the controlling persons of Lady Rose Stores, Inc. (See 'Lady Rose Stores, Inc.' herein) and are the persons who presented the Agreement of Merger to the Board of Directors of Masters for its consideration. In addition, said three individuals are Voting Trustees under a Voting Trust Agreement among stockholders of Masters. Said Voting Trust Agreement controls a majority of the issued and outstanding capital stock of Masters. (See 'Directors

and Management' herein and accompanying footnotes thereto for further particulars as to other relationships with Masters of certain directors of Masters.) Lady Rose Stores, Inc. operates ladies' soft goods leased concessions in Masters' stores, through corporate subsidiaries. (See 'Lady Rose Stores, Inc.' herein.)

"Lady Rose Stores, Inc. is the owner of 69,629 17/27 shares of the 460,732 outstanding stock of Masters* (all of these shares are represented by Voting Trust Certificates) (excluding shares of Masters held in the treasury of Masters as those represented by Voting Trust Certificates owned by Masters). Upon the effectiveness of the merger these shares, as represented by Voting Trust Certificates, will become treasury shares of Masters."

With respect to the fixing of the values, it is clear that the Biblowitz family was the source of the "Agreement" defined on the first page of the proxy statement as a "proposed Plan and Agreement of Merger" (81A) and annexed to it as an exhibit. Thus, the proxy statement clearly states that the completed document was "presented" by the Biblowitzes. It is submitted that the District Court's inference from the proxy statement that "at least the basic terms of the merger were presented to the board of Masters by the Biblowitz brothers", i.e., fixed by them (17A), is the only reasonable inference which can be drawn therefrom.

The statement immediately following the reference to the presentation of the agreement demonstrates the strength of the Biblowitzes' position in Masters. Taken with the preceding statement, the inference of control is inescapable. As the Court stated in *Lewis* v. *Dansker*, 357 F.Supp. 636 (S.D.N.Y. 1973) (p. 639, fn. 4):

"* * * with respect to the failure to disclose the 'domination' of IFC's board of directors by the Dan-

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* More than 10%.

skers, any shareholder could easily have inferred from the information which was supplied in the proxy statement, that the Danskers were controlling and influential members of the Board and that the purpose of the resolutions was to remunerate the Danskers. * * *"

3. *The Illusory "Negotiation"*

Appellants argue that the reference to "negotiations" was materially misleading because "there was not in fact and could not be any 'negotiation' in any meaningful sense" (Br. p. 4).

The District Court found that negotiations would be meaningless because of the Biblowitz control of both companies but quite properly noted also that the Biblowitz control of Masters and Lady Rose had been disclosed (24A). In addition, based on the poor financial condition of Masters discussed hereinbefore, which was known to its shareholders (15A), the District Court found that the claimed misrepresentation was not material (24A).

It is respectfully submitted that these findings are clearly supported by the record* and, as shown above, the proxy statement indicated that the Biblowitzes presented the "Agreement" to Masters. Thus, the shareholders were adequately informed that the terms had come from the Biblowitz family (*supra*, p. 50) and could not be misled by the inadvertent use of the word "negotiation".

4. *The Operating Losses of Masters Due To the Discontinued Florida Operations*

10. *Masters' Financial Condition*

The District Court found (20A, 21A):

"Defendants contend that losses from discontinued stores in a retail chain did not have to be segregated since the opening and closing of stores is an ordinary aspect of a retail chain's business. Moreover, defend-

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* The poor financial condition is discussed fully at pages 4 to 21 hereof.

ants offered evidence that it would have been impossible to estimate the extent of the losses attributable to the discontinued Florida stores since defendants could not ascertain to what extent central overhead expenses of Masters I would be reduced as a result of the closings or how overhead expenses should be allocated between the Florida and Metropolitan stores.

"However, the court regards the closing of the apparently most unprofitable stores within a small chain to be a fact of enough importance that stockholders should be informed not only of the sale but also, to the extent possible, of the losses attributable to the discontinued operations. *See* Accounting Series Release No. 153, CCH FEDERAL SECURITIES LAW § 72,071 (". . . [D]isclosure should be as to significant, known factors that might render past earnings statements, or particular items therein, not indicative of probable future operations.")

"While it might well have been impossible to pinpoint the extent of the losses attributable to the Florida operations during the six month period ending July 30, 1966, the stockholders should at least have been informed that a substantial proportion of the losses were attributable to discontinued operations.

"Nevertheless, while such an omission would ordinarily be 'material' within the meaning of Rule 10-b-5, the court finds that the omission was not 'material' in this case. However much the omission may have resulted in an overstatement of the poor condition of Masters I, reasonable stockholders aware of Masters' unpromising prospects would not have attached substantial importance to the fact omitted for the reasons stated *supra.*"

Two items require comment. First, it was not until June, 1973, some seven years after the proxy statement in issue that the Accounting Principles Board promulgated Opinion No. 30 which includes as one of its purposes:

"(3) to specify the accounting and reporting for disposal of a segment of a business * * *".

It defines "segment of a business" as:

> "* * * a component of an entity whose activities represent a separate major line of business or class of customer. * * * The fact that the results of operations of the segment being sold or abandoned cannot be separately identified strongly suggests that the transaction should not be classified as the disposal of a segment of the business. The disposal of a segment of a business should be distinguished from * * * the disposal of part of a line of business * * *."

Illustrative is an example in the Accounting Interpretations of APB No. 30, to wit:

> "A diversified company sells a subsidiary which manufactures furniture. The company has retained its other furniture manufacturing subsidiary. The disposal of the subsidiary, therefore, is not a disposal of a segment of a business but rather a disposal of part of a line of business."

Thus, segregation of the results of the operations of the Florida Masters stores does not meet the aforementioned requirements, and, segregation of those results would not have been in accordance with generally accepted accounting principles.

Second, the Masters shareholders should have inferred that the Florida operation substantially contributed to the company's losses because the proxy statement disclosed that the sale resulted in a loss of some $561,367 (102A). Certainly, Masters would not have been willing to incur such loss if it were not for the fact that the results of the operations at the three Florida stores constituted a substantial portion of Masters' overall losses. Suffice it is to say, however, that, as we have seen, the sale of these stores did not cure Masters' financial ills, witness the loss by the metropolitan stores, alone, of some $360,000 for the fiscal year ending January 28, 1967. Thus, the metropolitan stores were just as poor as those in Florida.

Masters' poor financial condition as disclosed by the record has hereinbefore been fully analyzed.

5. *Lady Rose's Income From Concessions in Masters Stores*

The District Court found (22A):

> "Upon the sale of Master Florida stores to Zayre Corporation in 1966, Lady Rose's concessions in those stores were terminated. Plaintiffs contend that the proxy statement should have disclosed this loss of a future source of income in its reporting of Lady Rose's net income for the six months ended August 31, 1966.
>
> "Plaintiffs argue that omission of this fact led stockholders to believe Lady Rose's future earnings would be higher than could reasonably be anticipated given the loss of the Florida concessions.
>
> "However, in view of Lady Rose's strong condition, the absence of any evidence that the Florida concessions were unusually profitable to Lady Rose and Lady Rose's large number of concessions at the time of the merger, the court concludes that the termination of the Florida concessions was not, for Lady Rose, such a '. . . significant, known factor[s] that might render past earnings statements not indicative of future operations.' Accounting Series Release No. 153."

It must be remembered that with the loss of its concessions in the Masters' Florida stores, Lady Rose's net income increased from $451,977 for the fiscal year ending February 28, 1966 to $527,000 for the eleven months ending January 28, 1967. Indeed, for the six months ended August 31, 1966, its total net income was $331,491 of which but $44,681 was derived from the Florida stores (40A).

Appellants also contend that there should have been disclosed to the Masters shareholders the amount of Lady Rose income derived from the Masters stores and argue that (Br. p. 7):

> "Thus, Lady Rose, without its concessions in Masters, would be significantly less profitable. * * *"

They omit, however, that such statement presupposes that Lady Rose would be unable to replace the loss with equally profitable concessions in other stores. Nor do they proffer evidence that the Lady Rose income from the Masters' concessions as a whole was unusually high. Since the Lady Rose income increased after the loss of the Masters Florida stores, it is obvious that it was capable of replacing lost business with equally profitable operations. This, then, at best for appellants is nothing more than an argument which could be made against the merger, all of which arguments are not required to be disclosed. *Abramson* v. *Nyquist, supra,* at page 524.

6. *Bases For Terms of Merger And the Unique Benefits Lady Rose Was To Obtain Incident To the Merger*

Appellants contend that certain facts used in setting the ratio of exchange of the Masters and Lady Rose should have been disclosed (Br. p. 8) without offering any legal support therefor. However, what was important to the Masters shareholders was the ratio of 10 to 1 itself —and that was disclosed (82A).

The proxy statement disclosed, in general, the various factors considered in setting the exchange ratio (81A), described the terms of the agreement and had a copy of the agreement appended to it and contained financial statements of both companies. Additional specificity, as urged by appellants, it is submitted, was not required.

Answering appellants' argument that the lack of an appraisal should have been disclosed in the proxy statement, in *Knauff* v. *Utah Mining & Construction Co., supra,* the court stated (p. 965):

> "The minority group complains that there was no independent appraisal of the properties of the two companies and that the omission of such an appraisal from the proxy statement makes it deceptive and misleading. We know of no legal requirement that the negotiators of a merger insist upon any certain type

> of appraisal or valuation. The question is whether in all the circumstances the negotiators exercised reasonably prudent judgment."

Since an appraisal is not required, there is no reason that the lack of an appraisal must be disclosed. Moreover, in view of the disclosure of the factors which were considered, and the absence of any reference to an appraisal, it is fair to say that a reasonable shareholder would not assume that independent appraisals or evaluations were obtained.

7. *Kalish Rubinroit & Co.'s Role.*

Appellants argue that the proxy statement failed to disclose that this firm of accountants allegedly were secretly working to obtain a maximum advantage to the Biblowitzes in the merger.

The District Court found (17A-19A):

> "Reasonable stockholders who had doubts about the fairness of a merger agreement between two corporations dominated by the same family might attach great weight to the financial information certified by independent accountants. Therefore, it would be important that the stockholders be informed that Kalish, Rubinroit were working for the Biblowitzes.
>
> "While the proxy statement could have made the divided loyalties of Kalish, Rubinroit clearer, their employment by Masters I and Lady Rose was disclosed. Page FS-10 of the statement set forth Kalish, Rubinroit's certification to the board of directors and stockholders of Lady Rose that the financial statements presented fairly the financial position of Lady Rose. Since the proxy statement clearly revealed that the Biblowitzes owned Lady Rose, Kalish, Rubinroit's employment by the Biblowitzes should have been inferred by reasonable shareholders. That they were also the accountant for Masters I was obvious from page FS-1 which contained a copy of their certification to the board of directors and shareholders of Masters I. (Pls. Exh. 2).

"While disclosure of the various services Kalish, Rubinroit performed for Mr. Biblowitz as his personal tax advisers would have put Kalish, Rubinroit's relationship to the Biblowitzes into sharper relief, the court does not believe that this fact was material in light of the proxy statement's revelation that Kalish, Rubinroit was working for Lady Rose.

"Plaintiffs do not explain the materiality of the fees paid to Kalish, Rubinroit for their work in connection with the merger. Masters' stockholders would have assumed that the accountants were being compensated by both Masters I and Lady Rose for their services. No evidence was introduced that their fees were contingent upon approval of the merger.

"It is difficult to understand the relevance of plaintiffs claim that the stockholders of Masters I should have been informed that Kalish, Rubinroit '. . . had been working at the behest of Mr. Biblowitz in preparing a plan of merger without disclosing that fact to Masters I. . . .'"

No evidence was offered by appellants that the certifications by Kalish, Rubinroit & Co. of Masters' financial statements appearing in the proxy statement were in any way improper. Indeed, appellants chose not to make the accounting firm a party defendant in the action, further evidence that such financial statements were considered by appellants to be correct.

8. *The Feldshuh & Frank Role.*

Appellants argue that the failure to disclose that the firm of Feldshuh & Frank allegedly had been the personal attorneys for the Biblowitzes, as well as the attorneys for Masters, was a material omission from the proxy statement. They conclude, without referring to any supporting evidence, that "they naturally expected to remain as attorneys for the surviving company, which in fact came to pass, the independence of their judgment and opinions was compromised" (Br., p. 9).

The mere fact that Feldshuh & Frank had acted as attorneys for the Biblowitzes is patently insufficient to justify a conclusion that they did not act independently and in the best interests of Masters. Indeed, in *Kohn* v. *American Metal Climax, Inc.*, 458 F.2d 255 (3d Cir. 1972), one of the cases relied on by appellants, the firm of Sullivan & Cromwell had represented both participants in a merger until a conflict appeared, at which time new counsel for one of the participants was retained. In the instant case, special counsel for Lady Rose Stores, Inc. was retained (57A, 112A). The District Court held that the failure to disclose Sullivan & Cromwell's representation of both parties was a material omission from the proxy statement. The Court of Appeals disagreed and stated (pp. 268-69):

"* * * Defendants admit that representation by Sullivan & Cromwell of both AMAX and RST continued until Late December, 1969. They admit also that this was during the period when amalgamation with AMAX was a possible alternative under consideration by the RST management. Defendants contend, however, that at no time during this period were the interests of AMAX opposed to those of the other RST shareholders. Rather, the conflict first arose when AMAX and RST commenced to negotiate amalgamation of RST with AMAX as a means of externalization. Defendants say that when this occurred Sullivan & Cromwell immediately advised RST that it could not represent it in such negotiations and that, pursuant to Sullivan & Cromwell's recommendations, RST retained new counsel for purposes of the amalgamation bargaining. In fact the district court found that from the outset of the RST-AMAX negotiations RST was represented by the New York firm of Winthrop, Stimson, Putnam & Roberts, as well as by English Counsel.

"From a review of the record we find that three dates emerge as pivotal in analyzing the district court's conclusion that a conflict of interest existed as to Sullivan & Cromwell's representation. The first is December 11, 1969, the date on which MacGregor on

behalf of AMAX proposed amalgamation to RST. Next is December 22, 1969, when the RST Board gave final approval to the Zambian-RST Agreement. Finally, there is January 9, 1970, the date of the firm amalgamation negotiating session between RST and AMAX.

"No evidence in the record permits an inference that after December 22, 1969, when the Zambian negotiations had ended, Sullivan & Cromwell advised RST to any extent concerning alternative means of externalization. Thus, the only period which need be considered is that from December 11, 1969, through December 22, 1969. During this time the Zambian negotiations still were not concluded. Consequently, the interests of RST and AMAX in these negotiations properly could be represented jointly by one counsel without any suggestion of a conflict of interest. Nothing in the record demonstrates that during this time Sullivan & Cromwell attempted dual representation of AMAX and RST concerning the amalgamation proposal. We do not consider the firm's efforts to advise RST generally concerning the several alternatives for externalization then being discussed as evidencing such a conflict."

9. *One of the Directors of Masters Voted Against the Merger and General Directors Stated That Masters' Value Was At Least Equal to Lady Rose's*

Appellants urge that the covering letter to the proxy statement (80A) was misleading because it did not indicate that Herbert Kurtz, a director of Masters, and an officer of the men's concessionaire at Masters, voted against the merger and that, at the board of Directors meeting, several directors stated that they thought that Masters value was higher than that assigned to it (Br., p. 10). Though Mr. Kurtz voted against the merger he wanted the following comment incorporated in the minutes (56A, 119A, 122A).

"I am in favor of the merger. My disagreement is only with the values that were reached as a basis for

the merger. I think the merger will be good for the Company."

Kurtz testified that his disagreement with the values in the proposed merger was simply a feeling reaction he had; he did not quantify his opinion (Tr. 2059, 2044, 2045). As a businessman, he was doing nothing more than negotiating a deal.

The District Court found that reasonable shareholders would not have construed the cover letter as stating that the directors' vote was unanimous (20A). It also found that although Kurtz, who was an executive vice-president of the men's wear concessionaire in Masters' stores, voted against the merger, the company for which he voted voted all of its shares in favor of the merger (56A, 57A, Tr. 571, 2040; Exh. P).

It is respectfully submitted that whether a reasonable shareholder would have assumed that the cover letter represented that the directors vote was unanimous is a question for the trier of fact, in this case, the trial judge. The letter indicates in its very first words that the "Board of Directors" approved the merger. Since such approval need not be unanimous and no representation as to unanimity was made, reasonable shareholders should have concluded that Louis Biblowitz was merely presenting the position of the board as a whole.

Needless to say, initial and intermediate positions of directors on any vote need not be disclosed; it is only the final one that is of moment.

11. *The Representation That the Merger Was "Fair and Equitable"*

The District Court found (24A):

> "The court rejects this claim since it finds that the terms of the merger were fair to the Masters stockholders."

This finding has hereinbefore been fully discussed.

At page 49 of their brief, appellants argue that under *Mills,* certain alleged omissions are materially misleading. As heretofore noted, there were no such omissions.

Moreover, as noted by Judge Friendly in *Gerstle* (p. 1301):

> "* * * Certiorari was granted in *Mills* to resolve the 'basic issue' raised by the holding of the court of appeals that it must be shown that the false or misleading statements in the proxy materials actually caused the shareholders to approve a merger, and that if the merger were shown to be fair, it would be conclusively presumed that a sufficient number of the stockholders would have approved it regardless of the defect in the proxy statement and thus there would be no liability. No issue as to the materiality of the misstatements or omissions was presented in the petition for certiorari and the Court specifically noted that it would not consider respondents' argument that the proxy statement was not materially misleading. * * *"

Inapposite is the reference to page 1294 of *Gerstle* at the same page relating to the decision of Louis Biblowitz to offer $770,000 for Masters and to accept $6,000,000 for Lady Rose. In *Gerstle,* this Court considered whether the failure to disclose a firm offer emanating from outside sources was a material omission. Here there was no offer other than that made by Louis Biblowitz.

At page 50, appellants argue that the failure to separate out the losses from the Florida operations gave an entirely distorted view of Masters metropolitan stores. It did not. Indeed, had the separation been made, the shareholders would have had a distorted view for they would have been led to believe that substantial losses would not recur when these stores lost $360,000 for the year ending January 31, 1967. Such failure in any event was not material since Masters shareholders would not have attached importance to it (21A). Thus, again the reference to *Gerstle* at page 50 of the brief is inapposite.

At page 51 and 52 of the brief, appellants contend that the failure to disclose the unique benefits Lady Rose allegedly was to obtain incident to the merger is a material omission under *Kohn.* The difficulty is, however, that when one examines page 8 of the brief it finds no such unique benefits.

At page 52 appellants cite *Republic Technology Fund* for the position that in a merger transaction the failure to disclose a discrepancy in earnings that was substantial was a material omission in violation of 10b-5. There, this Court was speaking of the earnings of the acquiring corporation. In any event, in the instant case, there was no discrepancy. What appellants complain of is that the valuation of $6,000,000 for Lady Rose was based on an estimated income of Lady Rose at a time when the Florida stores were closed and the concessions in the metropolitan stores were vulnerable to termination and that this information should have been but was not disclosed. The latter is of no significance since Masters was not interested in terminating Lady Rose in the metropolitan stores. The former is also of no significance since, as Whitman explained, no deduction in valuation should have been made therefor.

At pages 53 et seq. appellants argue that the Masters shareholders should have been told that Masters was valued at $777,000 and Lady Rose at $6,000,000 for the purpose of the merger. They contend that the District Court justified the failure to disclose the $777,000 figure on the ground that the terms of the merger were fair to Masters which begs the question because the whole purpose in disclosing information to shareholders is to enable them to determine whether they, and not the Court, believe the transaction to be fair, quoting *Mills* at page 55.

But this is a 10b-5 action in which appellants seek an appropriate remedy of restitution and not the setting aside of the merger and another vote thereon (Br. p. 69). As there noted:

> "It is, of course, too late to unscramble the merger effected in 1967; ***"

In *Mills*, the Court wrote (pp. 388, 389):

> "Monetary relief will, of course, also be a possibility. Where the defect in the proxy solicitation relates to the specific terms of the merger, the district court might appropriately order an accounting to ensure that the shareholders receive the value that was represented as coming to them. *On the other hand, where, as here, the misleading aspect of the solicitation did not relate to the terms of the merger, monetary relief might be afforded to the shareholders only if the merger resulted in a reduction of the earnings or earnings potential of their holdings.* In short, damages should be awarded only to the extent they can be shown. If commingling of the assets and operations of the merged companies makes it impossible to establish direct injury from the merger, relief might be predicated on a determination of the fairness of the terms of the merger at the time it was approved. * * *" (Emphasis added)

In the instant case, appellants offered no evidence of any reduction of shareholder earnings or earning potential,* choosing to stand on the sole premise that the terms of the merger were unfair. However, the District Court determined that the terms of the merger at the time it was approved were fair (26A; 27A) and that determination, as we have seen, was not clearly erroneous. Thus, even assuming that the proxy statement should have disclosed that for the purposes of the merger Masters was valued at $777,000 and Lady Rose at $6,000,000, indeed, should have disclosed all of the alleged omissions and not contained the alleged misrepresentations, since the terms of the merger were fair, appellants simply are not entitled to the relief requested.

This conclusion is in line also with the *Mills* discussion of causation, where the Court wrote (396 U.S. 385):

> "* * * Where there has been a finding of materiality, a shareholder has made a sufficient showing of causal relationship between the violation *and the injury for*

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* As we have seen, the earnings potential increased, not decreased (p. 46, *supra*).

which he seeks redress if, as here, he proves that the proxy solicitation itself, rather than the particular defect in the solicitation materials, was an essential link in the accomplishment of the transaction. * * *" (Emphasis added.)

Of this, the court in *Dasho* v. *The Susquehanna Corp.*, 461 F.2d 11 (7th Cir. 1972), commented (p. 30):

"* * * here the merger itself was apparently unobjectionable and a damage award must in effect, depend on a revision of the exchange ratio. Thus, although the *Mills* holding would seem to require a finding of 'legal injury' caused by the violation, in this case that injury may not include any pecuniary loss."

And, at page 31:

"In short, we think *Mills* takes us this far. If plaintiffs prevail on the issue of materiality, they have also established that approval of the 1.9 to 1 exchange ratio was unlawfully obtained. But that approval caused Susquehanna *monetary* injury only if (a) Susquehanna would have been better off with no merger at all; or (b) a more favorable exchange ratio would have been available if there had been full disclosure. The first alternative is not supported by any evidence which has been called to our attention; the second requires an evaluation of the transaction from Gypsum's view as well as Susquehanna's. For if it were plain from the record that Gypsum's shareholders would not in any event have approved a merger in terms which required surrender of more than 1.9 of their shares for each Susquehanna share, *then approval of these terms, even if unlawfully obtained, did not harm Susquehanna.*" (Emphasis added.)

And, in *Swanson* v. *American Commerce Industries, Inc.*,* 475 F.2d 516 (7th Cir. 1973), the court wrote (pp.

* In *Swanson*, the Court found that the plaintiffs had been damaged because they had lost their appraisal rights by virtue of the defendants' conduct. Damages to the plaintiffs was the value of those rights. Here, appellants did not have or lose any such rights.

519, 520):

"Applying the analysis of *Dasho,* approval of the sale of assets and reorganization caused plaintiff shareholders 'monetary injury only if (a) [Peoria] would have been better off with no merger at all; or (b) a more favorable exchange ratio would have been available if there had been full disclosure.' Id. at 31. The district court found that Peoria, during and prior to ACI control, was not a viable entity; that Peoria was unable, financially, to exploit the market available to it and unable to obtain such financing as was necessary for conversions of the corporation into a viable entity. 328 F.Supp. at 806. This finding is supported by ample evidence, and hence it is clear Peoria would not have been better off with no merger at all. As to the availability of a more favorable exchange ratio upon full disclosure, there was simply a failure of evidence to support a monetary recovery. *What suffices to show causation of a legal injury—the merger—does not automatically show plaintiffs suffered compensable monetary injury.* [D]amages should be recoverable only to the extent that they can be shown. Mills, supra, 396 U.S. at 389, 90 S. Ct. at 624." (Emphasis added.)

"* * * But the allegations of unfairness in the complaint were not proved. * * * This is a case where monetary relief is 'predicated on a determination of the fairness of the terms of the merger at the time it was approved.' *Mills, supra,* 396 U.S. at 389, 90 S.Ct. at 624. *The lower court having concluded that the terms of the merger were fair and reasonable at the time of the transaction, and we having concurred with that conclusion, the plaintiffs are not entitled to a retrospective revision of the merger terms."* (Emphasis added).

In the instant case, the evidence shows affirmatively that Masters would not have been better off with no merger at all and that a more favorable exchange ratio simply was not available under any circumstances. As hereinbefore

discussed, but repeated for the sake of convenience, as to the former, even Kurtz, who voted against the merger, stated:

> "I am in favor of the merger. * * * I think the merger will be good for the Company." (56A)

And, with reason. The Masters board had been kept informed of Masters' financial instability, losses (Exh. BG, pp. 20, 21; Tr. 48, 107, 110, 113, 138, 149), the attempts to find new management (a management consultant was hired who tried to attract competent people from Times Square Stores, J. M. Fields and Zayre Corp. with no success (Exh. AC; Tr. 1439, 1440, 2106)), the efforts to find a buyer for Masters (Tr. 72, 105) and that with only four stores, Masters could not exist (Tr. 113).

As stated in Treasury Department letter of February 28, 1967 (125A):

> "In January 1963 Masters filed a petition in Chapter XI proceedings in the Bankruptcy Court of the Southern District of New York. A plan of arrangement was confirmed, whereby Masters was obliged to pay out, in periodic monthly installments, a portion of the debts it owed creditors. A creditors' committee was formed to help carry out the plan of arrangement.
>
> "However, Masters deficit became larger. A report made by independent certified public accountants showed that Masters had an operating deficit of $2,705,583 since the adoption of the plan of arrangement. The creditors decided that Masters needed fresh capital assets to stop its deteriorating financial situation. Accordingly, the creditors' committee gave its consent for the merger described above."

From a survival point of view, it was essential for Masters to merge or combine with a financially strong viable company for it was in a financially precarious position, completely unable to show profits expected from its sales volume. The proposed merger with Lady Rose from

Masters' viewpoint would permit (Exh. 25, p. 17):

(a) a combined corporate net worth of over \$4,000,000, adequate to finance future expansion needs. This would include refurbishing and modernization of present stores, working capital for possible new operating units, credit approval for new lease commitments;

(b) combination with a successful retailer having a growing earnings experience, where in the first post-merger year Masters hoped to show significant profits for the first time in over ten years;

(c) an opportunity to develop a new, strong management team by attracting skilled personnel to a successful company;

(d) a broadening of the Masters product line base by moving into the important soft goods operation conducted; and

(e) a successful outlook for Masters. A long range prospect without expansion could only forecast the demise of Masters. The expansion and promotion of competitive retailers required similar expansion by Masters which was required either to keep up with its competition or ultimately fail (Exh. 25, p. 17).

At the meeting of Masters' board of directors at which the merger was approved, Kopelson, the treasurer and chief financial officer of Masters, was called upon to report Masters' posture and to give his opinion of the effects of the merger upon Masters. He reported that the net worth of the company following the disposal of the Florida stores was approximately \$1,600,000 to \$1,700,000. He stated that the cash paid by the purchaser of the Florida stores had been fully utilized by Masters to pay Florida creditors, the subordinated A and B debentures, for the acquisition of shares from Haizen, for obtaining a certificate of deposit of \$100,000 in connection with the payment of creditors under the Plan of Arrangement and for the deposit of \$50,000 as security incident to the renewal of the 48th

Street store lease. He pointed out that in the regular course of its business, Masters, at this time of the year, borrowed substantial funds from banks. However, up to that time, it had not borrowed any such funds although he anticipated that it would be required to attempt to do so. Kopelson further reported that Masters was facing a difficult operating situation. He stated that from an operating viewpoint, it was essential for Masters to acquire a fifth location so that its advertising, general and administrative expenses could be spread over a greater volume than that afforded by the four locations Masters then owned. He also stated that Masters experienced great difficulty in effecting lease arrangements because of the competition for locations by its competitors and others possessing a better financial position than Masters. In his judgment, the merger plan would lift Masters to a far better financial stature, thereby enabling Masters to deal more effectively in securing a fifth location as well as in dealing with suppliers (55A, 119A, 120A). Indicative of the fact that Masters would not have been better off without the merger, Kopelson voted his shares in favor of the merger (Exh. R).

As to the latter, Lady Rose was aware of all the facts which appellants allege should have been disclosed.* And no other company was at all interested in Masters. At the end of the adjourned meeting of the Masters directors, one director, Ginsburg, said he would speak with Vornado Corp. and Zayre Corp. (Tr. 135) apparently to no avail. Prior thereto Masters' counsel had asked Zayre Corp.'s counsel if Zayre Corp. were interested and he, and other directors, also asked if Rockower Bros., the men's wear concessionaire at Masters in 1966 whose designee was a member of Masters' board, were interested (Tr. 76, 112, 529) as did others (Tr. 112); Louis Biblowitz had discussions with Billy Blake Stores (Tr. 783, Whitman 126-128), with Flatbush Discount Stores (Tr. 786), with Times

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* Since two of the three Biblowitz brothers were initially opposed to the concept of a merger with Masters, it is not to be expected that they would have been in favor of a more favorable exchange ratio than was offered.

Square Stores (Tr. 787, 1403), with Grand Way (Tr. 878), with Hampton Sales (Tr. 786, 878), and with Friendly Frost (Tr. 254). Louis Biblowitz's offer was that he would sell control or half of control of Masters. This meant that the other party need not subject his entire company to the problems of Masters. Yet, not one of these entities was interested in associating itself with Masters (Tr. 783, 786, 878, Whitman 126-128) except Times Square Stores which offered to merge with Masters by paying Masters' shareholders out of Masters' profits, if any, and Kopelson had agreed with Louis Biblowitz that Masters should reject this offer (Tr. 880, 881) (39A).

Appellants, then, have failed to introduce evidence of either of the two prerequisites and, therefore, are not entitled to the retrospective revision of the merger terms which they seek, even assuming that there exists any omission or misrepresentation in the proxy statement and that any claimed omission or misrepresentation was material. The statement at page 57 of their brief that they have satisfied the causation requirement of Rule 10b-5 is simply wrong.

In any event, the District Court found the omission not material for another reason, namely (23A):

> "Nor can the court find that, given the poor condition of Masters I, the valuation given Masters was so low that reasonable shareholders might have considered the information as to the $777,000 valuation important in the making of their decision."

This is in accord with this Court's pronouncement in *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.*, 480 F.2d 341 (1973) with respect to materiality (p. 363):

> "* * * Account must be taken of all the surrounding circumstances to determine whether the fact under consideration is of such significance that a reasonable investor would weigh it in his decision whether or not to invest. * * *"

Suffice it to say, as shown hereinbefore, the District Court found the chaotic condition of Masters at the time the merger was presented to the Masters shareholders, a finding which was not clearly erroneous.

CONCLUSION

The judgment of the District Court dismissing the complaint should be affirmed.

Respectfully submitted,

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